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In the

Supreme Court of the United States

OCTOBER TERM, 1927

No. 150

JOHN C. DENNEY, as Director of Public Works of Washington; O. O. CALDERHEAD, as Supervisor of Transportation of Washington; and C. REA MOORE, as Supervisor of Public Utilities of Washington, the persons constituting the Department of Public Works of the State of Washington, and JOHN H. DUNBAR, Attorney General of the State of Washington,

Appellants,

vs.

THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY, a Corporation,

Respondent.

APPEAL FROM THE DECREE OF THE DISTRICT COURT OF THE UNITED STATES, FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION

Brief of Respondent

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Brief of Respondent

STATEMENT OF THE CASE

The Department of Public Works of the State of Washington (the members of which and the Attorney General are the appellants and are hereinafter re-

ferred to as the "Department") after an exhaustive investigation in which all parties in interest were fully heard, entered the order in suit on March 31, 1923, prescribing the telephone rates, both toll and exchange, to be charged by The Pacific Telephone and Telegraph Company, appellee (hereinafter referred to as the "Company") in and generally throughout the State of Washington, including the cities of Seattle and Tacoma.

A few days later this suit was commenced by the Company in the District Court of the United States, for the Western District of Washington, to enjoin the enforcement of these rates as being confiscatory of the property of the Company in violation of the due process provision of the Fourteenth Amendment.

An interlocutory injunction was applied for and granted by the three-judge court constituted under Section 266 of the Judicial Code, and thereafter the cause was heard by a Special Master upon whose report the court of three judges (organized pursuant to Section 266 as amended February 13, 1925, requiring three judges on final hearing) entered its final decree adjudging the rates confiscatory and granting a permanent injunction. The case below is *Pacific Tel. & Tel. Co. v. Whitcomb, et al*, reported in 12 Fed. (2d) 279. The opinion is in the Record, pp. 175 to 193.

The defense below presented two principal contentions, namely: first, that the rates were not confiscatory in effect, and, second, with respect to the cities Seattle and Tacoma, that the rates to be charged in those cities were contractual franchise rates, and therefore were not confiscatory in the constitutional sense, although non-compensatory.

The first contention has now been abandoned, and it stands admitted that the rates were confiscatory in effect. Only the second question is, therefore, presented upon this appeal. In deciding this question in favor of the Company, the court below said:

"In behalf of the cities of Seattle, Tacoma, and Spokane,* it is contended that the plaintiff companies are entitled to no relief because in these cities the companies were operating under franchises which prescribed rates substantially lower than those allowed by the department, and that the franchise rates are controlling, particularly since the department did not expressly and in pointed terms abrogate and cancel them. It cannot be doubted that where a franchise contract is entered into between a municipality and a public utility corporation fixing rates to be charged by the latter for a not grossly unreasonable period of time, such rates are binding and enforcible, even those confiscatory of the property involved. *St. Cloud Pub-*

*The reference to Spokane is due to the fact that the case of The Home Telephone and Telegraph Company against the Department (which involved Spokane rates only), and this case, were considered as consolidated for certain purposes by the Special Master and the Statutory Court.

lic Service Co. v. City of St. Cloud, 44 S. Ct. 492, 265 U. S. 352, 68 L. Ed. 1050. Nor can it be doubted that under the statutes of the state of Washington the department has the power to abrogate and cancel such franchise rates if in a proper case it sees fit to do so. Section 10379 of Remington's Compiled Statutes of Washington provides:

" 'Nothing in this act shall be construed to prevent any telegraph company or telephone company from continuing to furnish the use of its line, equipment, or service under any contract or contracts in force at the date this act takes effect or upon the taking effect of any schedule or schedules of rates subsequently filed with the commission, as herein provided, at the rates fixed in such contract or contracts: Provided, however, that the commission shall have power, in its discretion, to direct by order that such contract or contracts shall be terminated by the telephone company or telegraph company party thereto, and thereupon such contract or contracts shall be terminated by such telephone company or telegraph company as and when directed by such order. L. 1911, p. 567, § 43.'

"Construing this statute in the case of *State ex rel. Spokane v. Kuykendall*, 205 P. 3, 4, 5, 119 Wash. 107, 111, 112, the Supreme Court of Washington said:

" 'By the act of 1911 (Laws of 1911, p. 551, § 34) the terms of a franchise contract like the one in question here are binding upon the parties until the Department of Public Works (heretofore the Public Service Commission) has made an order directing a departure therefrom; and, without question, the de-

partment has the right and power to order a departure. *State ex rel. Ellertsen v. Home Tel. & Tel. Co.*, 172 P. 899, 102 Wash. 196. In the case of *State ex rel. Webster v. Superior Court*, 120 P. 861, 67 Wash. 37, L. R. A. 1915C, 287, Ann. Cas. 1913D, 78, it was decided that the Public Service Commission law places the entire subject of rate regulation under the control of the commission, that no contract between a city representing the public and a public service company would be allowed to interfere with that control, and by way of application of the rule, it was decided in that case to be the duty of the commission to the company to fix a rate which was sufficient (a rate that would afford a fair interest return on the investment), in spite of the franchise contract fixing rates which were too low. That, in legal effect, is what has been done in the present case.'

"In this same case the point was urged that the department, in fixing the new rates, did not in express terms cancel and terminate the franchise rates. Answering this contention, the court said:

" 'The present order of the Department of Public Works is just as effective as if, after fixing the rates, there had been added therein the words, "and it is hereby directed that the rates provided in the franchise shall be and they are hereby terminated," or words of similar import. That is the legal effect of what was done, and the form or language by which it was accomplished is not very material.'

"This holding is the construction of a state statute by the court of last resort of the state, and consequently is binding upon this court. The special master concluded that the order of the Public Service

Commission (now the Department of Public Works) entered on August 8, 1919, and after the termination of federal control of the properties, continuing in effect the rates established by the Postmaster General so far as the Pacific Company is concerned, and the orders of the department to the same effect entered on March 31, 1923, as to both the Pacific and the Home Companies, had the effect of terminating and abrogating the franchise rates, and that the rates established by the department in their stead became 'department' or 'statutory' rates, as distinguished from 'franchise' or 'contract' rates. In this we agree with him. *State ex rel. Spokane v. Kuykendall, supra.* It may be conceded that the department was not obliged to grant any relief against the rates stipulated in the franchises, and that it could not by judicial action be compelled to do so. Yet, if it undertakes to terminate such rates pursuant to its plain statutory powers, the rates substituted instead must be fair, just, and reasonable, if the plain mandate of the statute defining its duties is to be obeyed. And, when the substituted rates are challenged, they must be considered as statutory—not franchise—rates, and their character as being confiscatory or not must be measured by the principles of law applicable to such rates."

(12 Fed. (2d) 287, 288; R. pp. 189, 190, 191.)

We might well rest the company's case upon the foregoing opinion.

POINTS AND AUTHORITIES

When the Department by order prescribes telephone rates, the rate provisions of numerous franchises are *ipso facto* terminated and the rates so fixed by order of the Department, become department, or statutory, rates as distinguished from franchise or contract rates, and their character as being confiscatory or not must be tested by the general and familiar principles of law applicable to rate regulation. If such rates are confiscatory in their effect, they are void.

(a) The Supreme Court of the State of Washington has definitely so held.

State ex rel. Spokane v. Kuykendall, 119 Wash. 107.

See also—

State ex rel. Webster v. Superior Court, 67 Wash 37;

Puget Sound Traction Co. v. Reynolds, 244 U. S. 574-9.

(b) This construction of the state statute by the highest court of the State is binding upon the Federal courts.

Claiborne County v. Brooks, 111 U. S. 400;

Norton v. Shelby County, 118 U. S. 425;

Williams v. Eggleston, 170 U. S. 304;

Hunter v. Pittsburgh, 207 U. S. 161;

Old Colony Trust Co. v. Omaha, 230 U. S. 100;

Pacific Livestock Co. v. Oregon Water Board, 241 U. S. 440;

Pennsylvania R. R. Co. v. Towers, 245 U. S. 6;

New York & Queens Gas Co. v. McCall, 245 U. S. 345;

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Southern Iowa Electric Co. v. Chariton, 255 U. S. 539;

Douglas v. Noble, 261 U. S. 165;

Georgia Ry. & P. Co. v. Decatur, 262 U. S. 432;

Opelika v. Opelika Sewer Co., 265 U. S. 215;

Old Colony Trust Co. v. Tacoma, 230 Fed. 389.

The cases cited and relied upon by the Department in the companion case of *Home Tel. & Tel. Company v. Denney* are not in point.

Moreover, even in a case in which the Federal courts may exercise an independent judgment, the settled rule is that any reasonable doubt will be resolved in favor of that construction of a state statute

which has been adopted by the court of last resort in the state. In this case, the state rule is sound.

Yazoo & Mississippi Valley R. R. Co. v. Adams, 181 U. S. 580;

Burgess v. Seligman, 107 U. S. 20;

Barnum v. Okolona, 148 U. S. 393;

Kuhn v. Fairmont Coal Co., 215 U. S. 349;

Sim v. Edenborn, 242 U. S. 131.

(c) The Department will not be heard to controvert the construction of a state statute and a rule of public policy announced by the court of last resort of the state.

Southern Iowa Electric Co. v. Chariton, 255 U. S. 539;

Stewart v. Kansas City, 239 U. S. 14.

ARGUMENT

One of the Company's franchises to operate in the city of Tacoma was granted under Ordinance 2522, passed December 13, 1905, and duly assigned to the Pacific Company by an ordinance passed February 9, 1916. (R. pp. 165, 166). The ordinance named maximum telephone rates, and the rates prescribed by the Department, which are in controversy in this case, are in excess of the ordinance rates.

In Seattle, the Company formerly had two franchises: the Independent franchise, acquired by it in March, 1912, expiring January, 1926, and the Sunset franchise, acquired January 8, 1917, expiring in July, 1923. The Independent franchise contained provisions for maximum telephone rates for certain classes only of telephone service, which rates were lower than those prescribed by the Department's order of March 31, 1923, in controversy in this suit. For the purposes of this case no other facts concerning these ordinances are relevant.

On this appeal the appellee regards it as immaterial as to whether these franchises, or either of them, was in effect from time to time, the rate provisions of the Independent franchise having been terminated by the action of the Department as a matter of law.

The Railroad Commission of Washington, now the Department, in cause No. 31, made an order dated September 29, 1911, (prior to the purchase of said franchise by the Pacific Company) increasing telephone rates for all classes of service specified in the Independent franchise, in amounts greater than those fixed by the Independent franchise for such classes of service. The statement in appellants' brief, page 28, to the effect that all of the rates specified in the franchise were not increased by such order, is incorrect,

as an examination of the franchise provision (R. p. 144) and the rates fixed by the order of September 29, 1911 (R. p. 278), will demonstrate.

Thereafter, the Public Service Commission of Washington (formerly the Railroad Commission, now the Department) in cause No. 1825 made an order dated August 15, 1916, prescribing telephone rates for Seattle in excess of those specified in the Independent franchise or established by the order of September 29, 1911. (R., p. 223, 249.)

On August 1, 1918, the Postmaster General, under authority of Congress, took possession of the telephone lines of the Pacific Company and retained control until August 1, 1919. During the period of Federal control telephone rates were materially increased by the Postmaster General in the cities of Seattle and Tacoma. The Public Service Commission of Washington, on February 13, 1919, during the period of Federal control, made an order establishing the rates fixed by the Postmaster General as the rates of the Pacific Company. At the expiration of the period of Federal control, Congress provided that the rates theretofore fixed by the Postmaster General should continue in effect for a period of four months unless an application was made to the state commission, or other regulatory body, for other rates. On August 8, 1919, the Public Service Commission,

now the Department, made an order continuing the Postmaster General's rates in effect. (R. p. 286). The Department thereafter filed a formal complaint on January 21, 1922, challenging the rates of the Pacific Company, and entered upon an exhaustive investigation to which all interested persons were made parties, including the cities of Seattle and Tacoma. (R. p. 50.)

After a number of hearings in which witnesses were heard and full opportunity given for cross examination, the Department made the order in suit by which the Company's property was valued and existing rates continued in effect. In its investigation leading up to the order in suit, it is clear that the Department proceeded upon the theory that the franchise rates had no force and effect, and that it was in no way hampered thereby.

WHEN THE DEPARTMENT BY ORDER PRESCRIBES TELEPHONE RATES, THE RATE PROVISIONS OF MUNICIPAL FRANCHISES ARE IPSO FACTO TERMINATED AND THE RATES SO FIXED BY ORDER OF THE DEPARTMENT BECOME DEPARTMENT OR STATUTORY RATES AS DISTINGUISHED FROM FRANCHISE OR CONTRACT RATES AND THEIR CHARACTER AS BEING CONFISCATORY OR NOT MUST BE TESTED BY THE GENERAL AND FAMILIAR PRINCIPLES OF LAW APPLICABLE TO RATE REGULATION. IF SUCH RATES ARE CONFISCATORY IN THEIR EFFECT THEY ARE VOID.

THE SUPREME COURT OF THE STATE OF WASHINGTON HAS DEFINITELY SO HELD.

In the case of *State ex rel. Webster v. Superior Court*, 67 Wash. 37, it was contended by the City of Seattle that the rate provision in the franchise granted to the Independent Telephone Company could not be abrogated or terminated by the regulatory body of the state. The Supreme Court, in answer to that contention, said:

"It having been heretofore held that the constitutional power can be exercised through a commission with power to fix rates, and that the public is not bound to pass a general law fixing maximum rates, it follows that the public utilities act is a 'general law,' and under many decisions of this court, supersedes any ordinance or charter provision of any city which may conflict therewith. The power to fix rates is a mere detail in the execution of the general law, and cannot be insisted upon as the essential letter of the law."

And again—

"Where the state is a party, and it appears tha there has been no express grant or waiver of its con stitutional right to fix rates so as to give an ordi nance the force of a contract binding upon the stat (granting that under our constitution this could b done), it cannot be held, as a matter of either law o policy, that a franchise such as the one now unde consideration is a contract binding upon the Stat of Washington."

These principles have been reaffirmed many time by the Supreme Court of the State of Washingto but we think we need not quote from the decision so holding because this court itself, in the case o *Puget Sound Traction Co. v. Reynolds*, 244 U. S. 57 has clearly and succinctly stated the position of th Washington Supreme Court. In the case just men tioned it is said:

"Assuming (what is not clear) that the provisio in the franchise ordinances respecting the rates o fare and the transfer privilege are contractual i form, still it is well settled that a municipality ca not, by a contract of this nature, foreclose the exe cise of the police power of the State unless clearl authorized to do so by the supreme legislative powe The Constitution of Washington, Art. XII, § 18, r quires the Legislature to pass laws establishin reasonable maximum rates of charges for the tran portation of passengers and freight, and to corre abuses and prevent discrimination in rates by rai roads and other common carriers, and provides tha

'A railroad and transportation commission may be established, and its powers and duties fully defined by law.' By Art XI, § 10, any city containing a population of twenty thousand inhabitants or more is permitted to frame a charter for its own government 'consistent with and subject to the constitution and laws of this state.' This constitution was adopted in 1889, long previous to the date of the earliest of plaintiff's franchise ordinances. The Supreme Court of Washington has held that the provisions of municipal charters are subject to the legislative authority of the State; that the Public Utilities Act superseded any conflicting ordinance or charter provisions of any city; and that contractual provisions in franchises conferred by municipal corporations without express legislative authority are subject to be set aside by the exercise of the sovereign power of the State."

A more precise and exact announcement will be found in the case of *State ex rel. Spokane v. Kuykendall*, 119 Wash. 107, where the court, after stating the statutory provision here involved, said:

"Therefrom it appears to be argued that the rates provided in the contract should continue until the commission makes an order specifically declaring and directing in so many words that the contract shall be terminated. We may overlook the fact, if need be, that, upon the petition of the city, the rates were reduced in 1913, and that in 1918 they were increased upon the application of the gas company, and consider the franchise contract as having been wholly undisturbed until the present time, and still we would be compelled to determine, as we do determine, that the

present order of the Department of Public Works is just as effective as if, after fixing the rates, there had been added therein the words 'and it is hereby directed that the rates provided in the franchise shall be and they are hereby terminated,' or words of similar import. That is the legal effect of what was done, and the form or language by which it was accomplished is not very material."

THIS CONSTRUCTION OF THE STATE STATUTE BY THE COURT OF LAST RESORT OF THE STATE IS BINDING UPON THE FEDERAL COURTS

In *Norton v. Shelby County*, 118 U. S. 425, 439, this court said:

"Upon the construction of the constitution and laws of a state, this court, as a general rule, follows the decisions of her highest court, unless they conflict with or impair the efficacy of some principle of the Federal Constitution, or of a Federal statute, or a rule of commercial or general law. In these cases no principle of the Federal Constitution, or of any Federal law, is invaded, and no rule of general or commercial law is disregarded. The determination made relates to the existence of an inferior tribunal of the state, and that depending upon the constitutional power of the legislature of the state to create it and supersede a pre-existing institution. Upon a subject of this nature the Federal courts will recognize as authoritative the decision of the state court. As said by Mr. Justice Bradley, speaking for the court in Claiborne County v. Brooks, 111 U. S. 400, 410: 'It is undoubtedly a question of local policy with each state

what shall be the extent and character of the powers which its various political and municipal organizations shall possess; and the settled decisions of its highest courts on this subject will be regarded as authoritative by the courts of the United States; for it is a question that relates to the internal constitution of the body politic of the state'."

In *Pennsylvania R. R. Co. v. Towers*, 245 U. S. 6, Mr. Justice Day, speaking for this court said:

"The Court of Appeals of Maryland stated the question to be whether it is within the power of the Public Service Commission to require the establishment of a schedule of commutation rates by the railroad company, not where no such rates had theretofore been established, but where a new system of commutation rates had been proposed by the railroad company and submitted to the commission. Whether commutation rates should be established was declared to be a question of policy to be decided by the company. The court found authority in the commission under the statutes of Maryland to revise commutation rates where such rates had already been established by the action of the company. We must accept this definition of authority in the commission, so far as the state law is concerned, and direct our inquiry to the federal question presented."

In *Pawhuska v. Pawhuska Oil Co.*, 250 U. S. 394, the court said:

"It is not contended—nor could it well be—that any private right of the city was infringed, but only that a power to regulate in the public interest theretofore

confided to it was taken away and lodged in another agency of the state—one created by the state constitution. Thus the whole controversy is as to which of two existing agencies or arms of the state government is authorized for the time being to exercise in the public interest a particular power, obviously governmental, subject to which the franchise confessedly was granted. In this no question under the contract clause of the Constitution of the United States is involved, but only a question of local law, the decision of which by the Supreme Court of the state is final."

In *Douglas v. Noble*, 261 U. S. 165, there came before this court for consideration the dental law of the State of Washington. Mr. Justice Brandeis, speaking for this court, said that the construction of that statute

"* * * is a question of state law. Since the case is here on appeal from a Federal court, we must consider it, *Davis v. Wallace*, 257 U. S. 478. But in passing upon such questions we follow applicable decisions of the highest court of the state."

Again, in *Georgia Railway Co. v. Decatur*, 262 U. S. 432, 437, the court said:

"The principal question, and the one to which the briefs and arguments are mainly directed, is, whether the agreement between the plaintiff and the Electric Company was within the powers of the town and is now valid and subsisting. This contract has been before the Supreme Court of Georgia in the course of the litigation on three distinct occasions: 149 Ga. 1;

152 Ga. 143, and (the instant case) 153 Ga. 329. That court, in carefully considered and well reasoned opinions, sustained the authority of the municipality and upheld the contract as valid and subsisting. Defendants contend that the authority to fix rates devolved by the state constitution upon the General Assembly, and, therefore, that the Town of Decatur was without power to enter into a contract on that subject. When the contract was made the General Assembly had never exercised this authority and the State Supreme Court held that there was nothing in the constitution of the state which precluded the municipality from contracting as to fares; and that, while the matter was one falling within the police power, whose exercise could not be abridged by contract, it was competent for the municipality to enter into such a contract where the state had not exercised and was not seeking to exercise its police power over the subject, and that this contract would remain effective until there should be conflicting legislative action. See *Milwaukee Electric Ry. Co. v. Wisconsin R. R. Comm.*, 238 U. S. 174, 183. This conclusion involving, as it does, a construction of the state constitution and laws and powers of state municipalities, is controlling upon this court, as it has decided many times."

Finally, in the case of *Southern Iowa Electric Co. v. Chariton*, 255 U. S. 539, it appears that three different public utilities operating in three municipalities in the State of Iowa brought suits to enjoin the enforcement of maximum rates concededly confiscatory, but specified in the franchises granted by the

municipalities to the companies. The municipalities contended that they had the power to make a binding contract as to rates. The Supreme Court of Iowa had held that in that state there could not be a valid contract fixing permanent rates. Nevertheless, the trial judge dismissed the bills of complaint filed on behalf of the utilities. On appeal this court reversed the action of the court below, saying:

"The total want of power of the municipalities here in question to contract for rates, which is thus established, and the state public policy upon which the prohibition against the existence of such authority rests, absolutely exclude the existence of the right to enforce, as the result of the obligation of a contract, the concededly confiscatory rates which are involved, and therefore conclusively demonstrate the error committed below in enforcing such rates upon the theory of the existence of contract. And, indeed, the necessity for this conclusion becomes doubly manifest when it is borne in mind that the right here asserted to contract in derogation of the state law and of the rule of public policy announced by the court of last resort of the state is urged by municipal corporations whose every power depends upon the state law."

See also—

Claiborne County v. Brooks, 111 U. S. 400;

Williams v. Eggleston, 170 U. S. 304;

Hunter v. Pittsburgh, 207 U. S. 161;

Old Colony Trust Co. v. Omaha, 230 U. S. 100;

Pacific Livestock Co. v. Oregon Water Board, 241 U. S. 440;

New York & Queens Gas Co. v. McCall, 245 U. S. 345;

Maguire v. Reardon, 255 U. S. 271;

Opelika v. Opelika Sewer Co., 265 U. S. 215;

Old Colony Trust Co. v. Tacoma, 230 Fed. 389.

Now, how does the Department attempt to avoid the application of the rule stated in the foregoing cases? In the instant case no attempt at all is made. However, in the companion case of *The Home Tel. & Tel. Co. of Spokane v. John C. Denney et al* (No. 151), it is asserted that that case falls within an alleged exception to the rule we invoke, and the cases of *Pleasant Township v. Aetna Life Ins. Co.*, 138 U. S. 67, and *Louisville Trust Co. v. City of Cincinnati*, 76 Fed. 296, are relied upon as sustaining that view. But both of the cases cited involve private contract rights which had accrued prior to the decisions of the state courts. Neither of these cases involved the construction of a statute whereby the governmental power to regulate, subject to which a franchise had been granted, was taken away from a municipality and vested in another agency of the state.

Neither of the cited cases is, therefore, in point.

But if we view this cause from a somewhat different angle, nevertheless the same conclusion must follow.

For the sake of illustration, let us take the situation in Seattle. We readily agree that when the Independent Telephone Company in 1911 applied for rates in excess of those specified in the franchise, the Railroad Commission of Washington was not compelled to act on that application. But if it did act, what was its duty? Practically the whole purpose of regulation is to secure adequate service and to fix fair rates. It will not be questioned that a fair rate is one which is just, reasonable and sufficient. But if the regulatory body does not have the power to "terminate"—put an end to—rates which are unjust, unreasonable and insufficient, even though specified in a franchise, how can the purpose of regulation be carried out?

The construction, therefore, placed upon the statute by the Washington Supreme Court that it was "the duty of the Commission to the Company to fix a rate which was sufficient" (119 Wash. at p. 112) and that an order establishing rates at variance with franchise rates terminated such franchise rates is not only a reasonable, but also a sound construction of the statute.

Now, even in a case in which the Federal courts may exercise an independent judgment, the settled rule is that any reasonable doubt will be resolved in favor of that construction of a state statute which has been adopted by the court of last resort in the state.

In *Yazoo & Mississippi Val R'd. Co. v. Adams*, 181 U. S. 580, 582, it is said:

"The statutes of the State of Mississippi necessary to be considered for the purpose of ascertaining whether the taxes for the year 1892 accrued prior to October 24 of that year, are complex and difficult of interpretation. Assuming that we may exercise an independent judgment respecting their construction, the examination we have given them leaves us in great doubt whether the argument that the taxes had accrued prior to the consolidation is a sound one. The right asserted depends upon a comparison and construction of such statutes and the settled rule of this court is that, even in a case where we may exercise an independent judgment, any reasonable doubt will be resolved in favor of that construction of the state statute which has been adopted by the court of last resort in that state. *Burgess v. Seligman*, 107 U. S. 20; *Flash v. Conn*, 109 U. S. 371, 379; *Clark v. Bever*, 139 U. S. 96; *Board of Liquidation v. Louisiana*, 179 U. S. 622."

Again, in *Sim v. Edenborn*, 242 U. S. 131, 135, this court said:

"This court has many times considered how far federal tribunals, when undertaking to enforce laws

of the states, should follow opinions of their courts. The authorities were reviewed, and rule announced in *Burgess v. Seligman*, 107 U. S. 20, 33, 34, 35, which declared that, as to doctrines of commercial law and general jurisprudence, the former exercise their own judgment, 'But even in such cases, for the sake of harmony and to avoid confusion, the federal courts will lean towards an agreement of views with the state courts if the question seems to them balanced with doubt. This has been often reaffirmed."

See also—

Barnum v. Okolona, 148 U. S. 393;

Kuhn v. Fairmont Coal Co., 215 U. S. 349.

THE DEPARTMENT WILL NOT BE HEARD TO CONTROVERT THE CONSTRUCTION OF A STATE STATUTE AND A RULE OF PUBLIC POLICY ANNOUNCED BY THE COURT OF LAST RESORT OF THE STATE

Section 10379 is now and always has been a part of the regulatory law of the State of Washington. It is a part of the Act by which the regulatory body of that state was created. It is solely by virtue of that Act that the Department exists. Every particle of the power and authority of the Department is derived solely from that statute.

Now, on what conceivable theory may the Department, an agency of the state, say that the court of last resort of that state has misconstrued the very stat

ute which gives existence to the Department and from which is derived all its power and authority?

As we see it, this court has twice held that it is not open to an agent of the state to attack the construction put by the court of last resort of that state upon the statute creating such agent.

"And, indeed, the necessity for this conclusion becomes doubly manifest when it is borne in mind that the right here asserted to contract in derogation of the state law and of the rule of public policy announced by the court of last resort of the state is urged by municipal corporations whose every power depends upon the state law."

Southern Iowa Electric Co. v. Chariton, 255 U. S. 539, 546.

"Plaintiff in error is not impleaded as a taxpayer nor does he defend as such. He is sued as a county officer and defends by virtue of the exercise of his functions as a county officer. In other words, he defends by virtue of laws of which he is an instrument. Constituted by the laws of the state, he yet attempts to resist one of its laws. Whether he may do so is purely a local question."

Stewart v. Kansas City, 239 U. S. 14, 16.

Respectfully submitted,

H. D. PILLSBURY,
FRANK T. POST,
OTTO B. RUPP,
Solicitors for Respondent,

C. M. BRACELEN, ESQ.,
Of Counsel.

[redacted]

Supreme Court of the United States

[redacted]

No. [redacted] 151

JOHN C. DENNEY, AS DIRECTOR OF PUBLIC WORKS OF WASHINGTON; O. O. CALDERHEAD, AS SUPERVISOR OF TRANSPORTATION OF WASHINGTON; C. REA MOORE, ETC., ET AL., APPELLANTS,

vs.

[redacted] TELEPHONE AND TELEGRAPH COMPANY

[redacted]

[redacted]

(32,336)

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1926

No. 769

JOHN C. DENNEY, AS DIRECTOR OF PUBLIC WORKS OF WASHINGTON; O. O. CALDERHEAD, AS SUPERVISOR OF TRANSPORTATION OF WASHINGTON; C. REA MOORE, ETC., ET AL., APPELLANTS,

vs.

HOME TELEPHONE AND TELEGRAPH COMPANY

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF WASHINGTON

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JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., FEBRUARY 1, 1927

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IN UNITED STATES DISTRICT COURT, WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION

In Equity. No. 167-E

THE HOME TELEPHONE AND TELEGRAPH COMPANY OF SPOKANE, a Corporation, Plaintiff,

vs.

JOHN C. DENNEY, as Director of Public Works of Washington; O. O. Calderhead, as Supervisor of Public Utilities of Washington, and Frank R. Spinning, as Supervisor of Transportation of Washington, the Persons Constituting the Department of Public Works of the State of Washington, and John H. Dunbar, Attorney General of Washington, Defendants

AMENDED AND SUPPLEMENTAL BILL OF COMPLAINT—Filed May 21, 1925

To the Honorable Judges of the District Court of the United States for the Western District of Washington, Southern Division:

The Home Telephone and Telegraph Company of Spokane, a corporation organized and existing under the laws of the State of Washington, by consent, brings this its [fol. 3] Amended and Supplemental Complaint against the said defendants and thereupon complains and charges as follows:

I

That it is a corporation duly organized and existing under and by virtue of the laws of the State of Washington, having its principal place of business at Spokane in said State, and is a citizen of said State; that during all the times referred to in this complaint it has owned and operated and now owns and operates a telephone system, and has been and is now engaged in operating and conducting

a public telephone system in the City of Spokane and the territory adjacent thereto, referred to herein as the Spokane Exchange, and furnishing to the public telephone exchange service and both intrastate and interstate telephone toll service. That it has complied with all the laws of the State of Washington relating to corporations, has paid its annual license fee last past due, and is duly authorized to do business in said State.

II

That heretofore, to wit: on the 24th day of April, 1923, this plaintiff duly filed its original complaint in this Honorable Court against E. V. Kuykendall as Director of Public Works of the State of Washington, Hance H. Cleland as [fol. 4] Supervisor of Public Utilities of Washington and Frank R. Spinning, as Supervisor of Transportation of Washington, the persons then constituting the Department of Public Works of the State of Washington, and John H. Dunbar, Attorney General of the State of Washington.

III

That the defendant John C. Denney is now the duly appointed, qualified and acting Director of Public Works of the State of Washington and is a citizen and resident of the Western District of Washington; that O. O. Calderhead is now the duly appointed, qualified and acting Supervisor of Public Utilities of the State of Washington, and is a citizen and resident of the Western District of Washington; that said Frank R. Spinning is now the duly appointed, qualified and acting Supervisor of Transportation of the State of Washington and is a citizen and resident of the Western District of Washington; that said John C. Denney and said O. O. Calderhead and said Frank R. Spinning are now the members of and constitute the Department of Public Works of the State of Washington; that the defendant John H. Dunbar is the duly appointed, qualified and acting Attorney General of the State of Washington, and is a citizen and resident of the Western District of Washington.

[fol. 5]

IV

This suit is of a civil nature in equity, and is brought for the purpose of enjoining the enforcement of an order made by the said Department of Public Works on March 31, 1923, which said order prescribes the maximum rates and charges to be charged by plaintiff for intrastate telephone service in the City of Spokane and the territory adjacent thereto, for the reason that said rates and charges are confiscatory of plaintiff's property used or useful in furnishing said service to the public and in consequence said order seeks to deprive plaintiff of its property without due process of law, and denies to plaintiff the equal protection of the law in violation of its rights under the Fourteenth Amendment to the Constitution of the United States, and is therefore null and void.

The amount in controversy in this suit exceeds the sum or value of $3,000.00, exclusive of interest and costs.

V

That on August 8, 1919, the Public Service Commission of Washington, an administrative body duly created by the statutes of said State, and the predecessor of, exercising like powers as, the said Department of Public Works, made [fol. 6] an order prescribing the maximum rates and charges to be charged by plaintiff on and after August 1, 1919, for telephone service, in the Spokane Exchange. A copy of said rates is filed herewith, marked Exhibit "A" and hereby specially referred to and made a part hereof.

VI

That on September 20, 1922, plaintiff filed with the said Department a schedule of rates increasing the rates to be charged by plaintiff for exchange telephone service in said Spokane Exchange. A copy of said schedule is filed herewith, marked Exhibit "B" and hereby specially referred to and made a part hereof.

VII

That on September 24, 1922, the said Department issued an order suspending for the full statutory period the opera-

tion of said rates so filed by plaintiff on September 20, 1922.

VIII

That subsequent to the dates herein before mentioned said Department held hearings in the City of Spokane for the purpose of determining the value of plaintiff's property used and useful in rendering telephone service therein; the reasonableness or unreasonableness of the rates and charges then being charged by plaintiff in said exchange; and the reasonableness or unreasonableness of the schedule of ex- [fol. 7] change rates for the Spokane Exchange filed by it as aforesaid on September 20, 1922. That on the 31st day of March, 1923, said Department made an order, a copy of which is filed herewith, marked Exhibit "C" and hereby specially referred to and made a part hereof, determining the value of plaintiff's property used for the public convenience in rendering telephone service in the Spokane Exchange as of June 30, 1922. That on the 31st day of March, 1923, two of the three members of said Department made an order, a copy of which is filed herewith, marked Exhibit "D" and hereby specially referred to and made a part hereof, whereby the application of plaintiff to increase its rates for telephone service in said Spokane Exchange was denied. That on the same date, to wit: March 31, 1923, the Supervisor of Public Utilities and a member of said Department, who was present at all of said hearings, filed a dissenting opinion, a copy of which is filed herewith marked Exhibit "E" and hereby specially referred to and made a part hereof, by the terms of which he found that the rates then and theretofore being charged by plaintiff in its Spokane Exchange were unreasonable and less than sufficient, and in which he fixed certain rates as reasonable and not more than sufficient. That said rates so found as reasonable by said Supervisor of Public Utilities, as set forth in [fol. 8] said dissenting opinion, Exhibit "E," are the rates set forth by plaintiff in the schedule filed herewith, marked Exhibit "F" and hereby specially referred to and made a part hereof, which the plaintiff in its original complaint, filed in this cause, proposed to establish and make effective pending the final decree in this cause, and which rates the plaintiff, under a certain injunctive order hereinafter re-

ferred to, did establish and make effective on August 1, 1924, as hereinafter set forth.

IX

The cost to plaintiff of its property in the Spokane Exchange (land being included at present value) and used or useful in furnishing intrastate and interstate telephone service to the public therein, and exclusively devoted to the rendition of that service was, as of the 30th day of June, 1922, the sum of $4,056,215, and that said cost is substantially the rate base fixed for said plaintiff (as of June 30, 1922) by the Department of Public Works in its said order of March 31, 1923.

X

The cost to plaintiff of its property in the Spokane Exchange (land being included at present value) and used or useful in furnishing intrastate telephone service to the public therein and exclusively devoted to the rendition of that [fol. 9] service was, as of the 31st day of December, 1922, the sum of $4,073,399.

The cost of reproduction of said property as it existed on the 31st day of December, 1922, was the sum of $7,793,411.

The cost of reproduction of said property, less depreciation, was, as of the 31st day of December, 1922, the sum of $7,145,314.

The fair and reasonable value of said property was, as of December 31, 1922, the sum of $5,497,049.

The foregoing statement as to the cost to plaintiff of said property includes nothing on account of the item of franchise or the item known as "going concern" value, but said latter item has been considered in the cost of reproduction and the fair and reasonable value of said property.

XI

The fair annual return which plaintiff is entitled to earn under rates imposed upon it by public authority is an amount equal to not less than eight per cent of the fair and reasonable value of its property used or useful in the rendition of the service covered by the rates in question.

XII

Plaintiff's telephone business in the Spokane Exchange has been conducted efficiently and economically during all [fol. 10] the times herein referred to. Plaintiff's net earnings derived from its intrastate telephone business within the Spokane Exchange as stated in rate per cent annual return on the cost of the property on the one hand, and on the fair value thereof on the other, said property being used or useful in furnishing said intrastate service and exclusively devoted to the rendition thereof, during each of the years stated below, have been as follows:

	On cost	On fair value
1919	2.99%	2.17%
1920	1.81%	1.32%
1921	2.38%	1.74%
1922	3.17%	2.34%

That at all of the dates aforesaid the fair and reasonable value of said property has been an amount substantially in excess of its cost.

XIII

That the rates of plaintiff in the Spokane Exchange established and in force as herein set forth during the years 1919, 1920, 1921 and 1922 and which were in effect under the order of the Department of Public Works of March 31, 1923, until July 23, 1924, when under an injunctive order hereinafter referred to, a schedule of rates filed herewith and marked Exhibit "F" were established, were and are not compensatory and were and are less than just and reasonable rates; that the amounts by which the net revenues [fol. 11] derived by the plaintiff from its intrastate telephone business in the Spokane Exchange were less than 8 per cent of the cost of the property on the one hand, and on the fair value thereof on the other, said property used or useful and exclusively devoted to the rendition of that service, were for the years:

	On cost	On fair value
1919	$188,809	$302,761
1920	233,681	347,572
1921	215,516	329,408
1922	192,892	306,784

That the maintenance of the rates and charges as aforesaid in Exhibit "A" under the order of the said Department of March 31, 1923, did compel and, if said rates were re-established, would compel the plaintiffs to provide intrastate service at rates which were and are not compensatory and which were and are less than just and reasonable, and resulted and, if said rates were re-established, would result, in the confiscation of the property of plaintiff in the Spokane Exchange devoted to public use and used or useful in rendering intrastate telephone service, and deprived, and, if said rates were re-established, would deprive, plaintiff of its property without compensation and without due process of law, and denied, and, if said rates were re-established, would deny to plaintiff the equal protection of the law in violation of the Constitution of the United States, particularly Article V and the Fourteenth Amendment [fol. 12] ther of. That said order of March 31, 1923, is therefore null and void.

XIV

That on the 30th day of April, 1923, plaintiff applied to a statutory court convened as provided for by Section 266 of the Judicial Code of the United States, for a temporary injunction in conformity with the prayer set forth in its original complaint; that on said 30th day of April, 1923, said application was denied.

XV

That thereafter this plaintiff renewed its application for a temporary injunction, and such application was heard by a statutory court convened as provided for by Section 266 of the Judicial Code of the United States, and thereafter such application was granted by said last named court, and a temporary injunctive order, in conformity with the prayer set forth in said original complaint and the prayer in this amended and supplemental complaint, was entered and filed on July 23, 1924.

XVI

That inasmuch as the charges for exchange service are billed in advance and the sum of money generally due monthly for exchange service from each of the subscribers

and patrons of the plaintiff is small it was not feasible or [fol. 13] practicable to make said injunctive order effective as to charges for telephone service until August 1, 1924.

XVII

That at all times after March 31, 1923, and down to the 23rd day of July, 1924 the rates for telephone exchange service prescribed by said order of March 31, 1923, were in full force and effect and were the rates and charges collected by this plaintiff for its telephone exchange service in the Spokane Exchange until August 1, 1924.

XVIII

The cost to plaintiff of its property in the Spokane Exchange (land being included at present value) and used or useful in furnishing its intrastate telephone service to the public therein and exclusively devoted to the rendition of that service was, as of the 31st day of December, 1923, the sum of $4,204,898; and as of the 31st day of July, 1924, the sum of $4,517,382. The fair and reasonable value of said property was, as of the 31st day of December, 1923, the sum of $5,628,549, and as of July 31st, 1924, the sum of $5,941,033.

The foregoing statement as to the cost to plaintiff of said property, as of the dates in this paragraph mentioned, includes nothing on account of the item of franchise or the item known as "going concern" value, but said latter item [fol. 14] has been considered in determining the fair and reasonable value of said property.

XIX

That throughout the year 1923 and from January 1st, 1924, to August 1st, 1924, this plaintiff practiced all reasonable economies consistent with adequate and efficient service to the public; that its net earnings derived from its intrastate telephone business in the Spokane Exchange stated in rate per cent annual return upon the cost of the property on the one hand and upon the fair value thereof on the other, said property being used or useful in furnishing its intrastate telephone service and exclusively devoted to the rendition thereof, during each of the periods stated, were as follows:

	On cost	On fair value
1923	3 88%	2 89%
Jan. 1, 1924, to Aug. 1, 1924, (annual basis)	4 03%	3 04%

That the amounts by which the net revenues derived by the plaintiff from its intrastate telephone business in the Spokane Exchange during each of the periods stated were less than eight per cent of the cost of the property on the one hand and of the fair value on the other, said property being used or useful and exclusively devoted to the rendition of intrastate telephone service in the Spokane Exchange, were as follows:

	On cost	On fair value
1923	$170,959	$284,851
Jan. 1, 1924 to Aug. 1, 1924 (annual basis)	173,038	286,929

[fol. 15]

XX

The cost to plaintiff of its property in the Spokane Exchange (land being included at its present value) and used or useful in furnishing its intrastate telephone service to the public therein, and exclusively devoted to the rendition of that service was, as of the 31st day of December, 1924 the sum of $4,624,812. That the cost to plaintiff of its said property is now somewhat in excess of the cost of said property as of December 31, 1924, on account of the additions and betterments in the meantime made to said property. The fair and reasonable value of said property was, as of the 31st day of December, 1924, the sum of $6,048,462.

The foregoing statement as to the cost to plaintiff of said property as of the date in this paragraph mentioned, includes nothing on account of the item of franchise or the item known as "going concern" value, but said latter item has been considered in determining the fair and reasonable value of said property as in this paragraph stated.

XXI

That throughout the period from July 31, 1924, to December 31, 1924, this plaintiff practiced all reasonable economies consistent with adequate and efficient service to

the public; that plaintiff's net earnings derived from its [fol. 16] intrastate telephone service in the Spokane Exchange stated in rate per cent annual return upon the cost of the property on the one hand and upon the fair value thereof on the other, said property being used or useful in furnishing its intrastate telephone service to the public, and exclusively devoted to the rendition thereof, during said period, were—(annual basis) on Cost, 6.44%; on Fair Value, 4.92%.

That the amounts by which the net revenue derived by plaintiff from its intrastate telephone business in the Spokane Exchange were less than eight per cent of the cost of the property upon the one hand and upon the fair value thereof on the other, said property being used or useful in furnishing said intrastate service and exclusively devoted to the rendition thereof, during the period of August 1, 1924, to December 31, 1924, were (annual basis) on Cost $71,232; on Fair Value, $185,124.

XXII

That plaintiff avers that the rates and charges set forth in said Exhibit "F" and which have been the rates and charges collected by it during the period August 1, 1924, to December 31, 1924, are less than the just and reasonable rates and charges to which plaintiff is lawfully entitled, but are the rates and charges which plaintiff has estab- [fol. 17] lished and put into effect under said injunctive order of July 23, 1924, pending the final decree in this cause.

XXIII

That the plaintiff has no adequate remedy at law, and should it fail to observe the rates and charges specified in said schedule Exhibit "A" and make and enforce the rates and charges as specified in Exhibit "F" or any rates or charges higher than those specified in said Exhibit "A," or any rates not sanctioned by the Department of Public Works of Washington, the defendants will, unless restrained by the order of this court, institute and cause to be instituted proceedings to compel compliance with said schedule Exhibit "A," and the plaintiff, its directors, officers, agents and employees will be subjected to a multi-

plicity of suits and incr the penalties and punishments prescribed by the laws of the State of Washington, and may, under the provisions of said laws, be charged with the commission of gross misdemeanors, each punishable under the laws of Washington by a fine of $1,000, or imprisonment in a county jail of one year, or both.

That unless the defendants are restrained and enjoined as herein prayed, plaintiff, its directors, officers, agents and employees, will be deterred and prevented by the threat [fol. 18] of numerous and excessive fines and of imprisonment as aforesaid, from putting into effect the said schedules of rates and charges in said Exhibit "F," or any rates and charges other than those provided in said Exhibit "A," and thereby plaintiff will be forced to submit to the confiscation of its property without due process of law and in violation of its rights under the Constitution of the United States, as hereinbefore alleged.

That unless the defendants are restrained and enjoined, as herein prayed, plaintiff's subscribers and other patrons will be induced and caused to resist and refuse payment of any rates and charges other than those provided in said Exhibit "A." That because of the nature of the business of the plaintiff and the small sums of money generally due monthly from each of its subscribers and patrons, it is impracticable for plaintiff to enforce collection thereof by actions at law, and as a result thereof plaintiff's property will be confiscated as aforesaid. That plaintiff has no practical way to enforce and collect its rates and charges except by cutting off and refusing service for default in payment of its bills rendered monthly therefor, and its subscribers and patrons will, as plaintiff believes and so alleges, institute large numbers of suits to restrain plaintiff from cutting off and denying service for such non-pay[fol. 19] ment of bills and for damages, and plaintiff will thereby be subjected to an endless multiplicity of suits, and plaintiff's property will be confiscated, to plaintiff's irreparable loss and damage, all as hereinbefore alleged.

That large numbers of suits will be brought by defendants and plaintiff's subscribers and patrons to restrain and enjoin plaintiff, its directors, officers, agents and employees, from putting into effect said schedule Exhibit "F," or any schedule other than said Exhibit "A," and

to compel plaintiff to furnish telephone service for the unlawful and confiscatory rates provided in said schedule Exhibit "A." That the issues which will be presented in each said suit are presented and should and will be decided in this action.

Wherefore the plaintiff prays the judgment and decree of this Court:

First: That the rates and charges set forth in said schedule Exhibit "A" and prescribed by said Department of Public Works, be decreed to be confiscatory, in violation of the Constitution of the United States and the said order of March 31, 1923, imposing the same to be void and of no effect.

Second. That defendants, and each of them, and all other persons be permanently restrained and enjoined from any attempt to compel the plaintiff, its officers, agents and [fol. 20] employees, to observe, maintain or keep in force the rates, tariffs and charges now prescribed by said Department of Public Works, as set forth in said schedule Exhibit "A" filed herewith, or from any attempt to compel the plaintiff to continue to observe or maintain said rates or charges.

Third. That defendants, and each of them, and all other persons be permanently restrained and enjoined from any attempt to interfere with or prevent the plaintiff, its directors, officers, agents and employees, from charging and collecting the rates and charges set forth in said Exhibit "F" until just and reasonable schedules of rates and charges are established according to law.

Fourth. That the defendants, and each of them, and all other persons be permanently restrained and enjoined from taking any steps or proceedings against the plaintiff, its directors, officers, agents or employees, to enforce any penalty or remedy against the plaintiff, its directors, officers, agents or employees, for disregarding said rates and charges, Exhibit "A."

Fifth. That the plaintiff have such other and further relief as may be just and equitable in the premises.

May it please your Honors to grant unto the plaintiff a writ of subpœna of the United States of America issuing [fols. 21 & 22] out of and under the seal of this Honorable Court, directed to the said John C. Denney, O. O. Calderhead, Frank R. Spinning and John H. Dunbar, commanding them, and each of them, to answer unto this amended and supplemental complaint, but not under oath (answer under oath being hereby expressly waived) and to obey and perform such order and decree in the premises as to the Court may seem proper and required by the principles of equity and good conscience; and the plaintiff will ever pray.

The Home Telephone and Telegraph Company of Spokane, Otto B. Rupp, Post, Russell & Higgins, Pillsbury, Madison & Sutro, Its Solicitors.

Duly sworn to by W. J. Phillips. Jurat omitted in printing.

[fol 23] Exhibit "A"

The Home Telephone and Telegraph Company of Spokane

Exchange Rates—Spokane, Wash., Effective August 1, 1919

W. P. S. C. No. 2, Section 1

The Home Telephone and Telegraph Company of Spokane

Exchange Rate Schedule

Exchange—Spokane, Spokane County, Washington

Business—Unlimited Service

	Rate per month	
	Wall set	Desk set
Individual Line	$7.50	$7.75
Two-party Line	...	...
Extension (with or without bell)	1.00	1.00
Suburban Service—Two-party Line (See Section 3)	3.50	3.75

Residence—Unlimited Service

Individual Line	3.25	3.50
Two-party Line	2.50	2.75
Four-party Line	2.00	2.25
Extension (without bell)	.50	.75
Extension (with bell)	.65	1.00
Suburban Service—Two-party Line (See Section 3)	3.00	3.25

Primary Rate Area—See Map**

Rates are effective inside Primary Rate Area unless otherwise indicated. For service outside Primary Rate Area, see Mileage Rates, Section 3.

Issued: April 1, 1919. Effective: April 1, 1919.*

[fol. 24] Cancels and supersedes Exchange Rate Schedule effective February 20, 1915.

C. E. Hickman, General Manager.

W. P. S. C. No. 2, Section 1

The Home Telephone and Telegraph Company of Spokane

Exchange Rate Schedules

Exchange: Spokane, Spokane County, Washington

Business—Measured Service

	Rate per month		Exchange messages per month	Each additional exchange message
	Wall set	Desk set		
Individual Line	$3.50	$3.75	100	$ .04
Auxiliary Line	2.50	2.75	...	...
Extension (With or without bell)	.75	.75	...	...

Residence—Measured Service

Individual Line	....	....	....	....
Extension (Without bell)	....	....	....	....
Extension (With bell)	....	....	....	....

Business—Coin Box

	Rate per day		Exchange message per day	Each additional exchange message
	Wall set	Desk set		
Individual Line	$ .15	†	3	$ .05
Extension (With or without bell) per month	1.00	1.00	...	...

Residence—Coin Box Service

Individual Line	....	....	....	....
Extension (Without bell) per month	....	....	....	....
[fol. 25] Extension (With bell) per month	....	....	....	....

Issued: April 1, 1919. Effective: April 1, 1919.*

Cancels and supersedes Exchange Rate Schedule effective February 20, 1915.

C. E. Hickman, General Manager.

**Opportunity Exchange—Two-mile radius from central office.

*In accordance with Order of the Public Service Commission of Washington in Case No. 4747.

†25c per month additional.

W. P. S. C. No. 2, Section 2

The Home Telephone and Telegraph Company of Spokane

Exchange Rate Schedule

Private Branch Exchange Service

Business Hotel—Unlimited Service

	Rate per month	
Switchboard, with battery power, ringing circuit and switchboard telephone for each position, equipped for 15 lines	$2 00	
Additional switchboard equipment for each group of 5 lines or less	20	
First bothway trunk line—Individual business rate plus $2.00 per month.		
Each additional bothway trunk line—Rate for first bothway trunk line less 25%.		
Each incoming trunk line—Individual business rate less 20%, minimum $4.00 per month.		
	Wall set	Desk set
Each Station, primary or extension not in guest rooms (see mileage Rates Section 3)	$1 00	$1 00
Each Station, primary or extension in guest rooms:		
1 to 50, inclusive	50	75
11 to 20, inclusive	45	70
21 to 35, inclusive	40	65
36 to 50, inclusive	35	60
Over 50	25	50

[fol. 26] Minimum installation: Two (2) trunk lines and ten (10) stations excluding switchboard telephone.

The switchboard is furnished in any standard size to meet the subscriber's requirements.

Rates are effective inside Primary Rate Area unless otherwise indicated. For service outside Primary Rate Area, see Mileage Rates, Section 3.

Issued: April 1, 1919. Effective: April 1, 1919.*
Cancels and supersedes Exchange Rate Schedule effective February 20, 1915.

C. E. Hickman, General Manager.

W. P. S. C. No. 2, Section 2

The Home Telephone and Telegraph Company of Spokane

Exchange Rate Schedule

Private Branch Exchange Service

Business Hotel—Measured Service

	Rate per month	
Switchboard with battery power, ringing circuit and switchboard telephone for each position	None.	
Trunk Lines—Bothway only	None.	
(Enough bothway trunk lines will be provided to properly handle the traffic.)		
Each exchange message	$0 25	
	Wall set	Desk set
Each station, primary or extension not in guest rooms (see Mileage Rates, Section 3)	$1 00	$1 00
Each station, primary or extension in guest rooms:		
1 to 10, inclusive	50	75
11 to 20, inclusive	45	70
21 to 35, inclusive	40	65
36 to 50, inclusive	35	60
Over 50	25	50

[fol. 27] Minimum installation: Ten (10) stations, excluding switchboard telephones.

The switchboard is furnished in any standard size to meet the subscriber's requirements.

*In accordance with Order of the Public Service Commission of Washington in Case No. 4747.

Rates are effective inside Primary Rate Area unless otherwise indicated. For service outside primary Rate Area, see Mileage Rates, Section 3.

Issued: April 1, 1919. Effective: April 1, 1919.*

Cancels and supersedes Exchange Rate Schedule effective February 20, 1915.

C. E. Hickman, General Manager.

W. P. S. C. No. 2, Section 3

The Home Telephone and Telegraph Company of Spokane

Exchange Rate Schedule

Farmer Line Service

Total Number of Stations

	Rate per year
300 stations or less	$3 00
300 to 500 stations	3 60
500 to 750 stations	4 20
750 to 1,000 stations	5 40
1,000 to 2,000 stations	7 20
2,000 to 4,000 stations	8 40
4,000 to 6,000 stations	9 60
6,000 to 8,000 stations	10 80
8,000 to 12,000 stations	12 00
12,000 stations and over	15 00

Company Furnishes—For not less than 5 subscribers per circuit, switchboard, and facilities to boundary of Primary Rate Area, except where city or town limits are beyond this boundary. In such cases, Company furnishes facilities to city or town limits. Central Office Service. Listing in Directory. Code Ring Card.

Subscriber Furnishes—Facilities to boundary of Primary Rate Area, except where city or town limits are beyond this boundary. In such cases, subscriber furnishes [fol. 28] facilities to city or town limits. Complete tele-

*In accordance with Order of the Public Service Commission of Washington in Case No. 4747.

phone and battery, sub-station protection. Maintenance of above.

The subscriber will be allowed a discount of Ten Per Cent (10%) on the charge for exchange service, if bill is paid at the Company's office during the first month of the year. New subscribers will be billed from the date of connection to the end of the year, and annually in advance thereafter. Initial bills rendered new subscribers will be subject to a Ten Per cent (10%) discount on the charge for exchange service, provided the bill is paid at the Company's office within thirty days after date of bill.

Farmer Line stations shall not be located within the Primary Rate Area.

Issued: April 1, 1919. Effective: April 1, 1919.*

Cancels and supersedes Exchange Rate Schedule effective February 20, 1915.

C. E. Hickman, General Manager.

[fol 29] EXHIBIT "B"

The Home Telephone and Telegraph Company of Spokane

Exchange Rates—Spokane, Wash. Filed September 20, 1922, and Not Withdrawn

W. U. P. W. No. 3, Section 1

The Home Telephone and Telegraph Company of Spokane

Exchange Rate Schedule

Exchange—Spokane and Opportunity, Spokane County, Washington

Business—Unlimited Service

	Rate per month	
	Wall set	Desk set
Individual Line	$10.00	$10.25
Extension (With or without bell)	1.00	1.25
Suburban Service—Ten party Line (see Section 3)	3.50	3.75

Business—Measured Service

	Rate per month		Exchange messages per month	Each additional exchange message
	Wall set	Desk set		
Individual Line	$5.50	$5.75	110	$.05
Extension (With or without bell)	.75	1.00	...	...

*In accordance with Order of the Public Service Commission of Washington in Case No. 4747.

[fol. 30] Semi public—Coin Box Service

	Rate per day		Each exchange message
	Wall set	Desk set	
Individual Line	$ .20	$*	$ .05
Extension (with or without bell) per month	1.00	1.25	..

Residence—Unlimited Service

	Rate per month	
	Wall set	Desk set
Individual Line	$4.00	$4.25
Two Party Line	3.25	3.50
Four party Line	2.75	3.00
Extension (With or without bell)	.75	1.00
Suburban Service—Ten party Line (see Section 3)	3.00	3.25

Primary Rate Area—See Map

Rates are effective inside Primary Rate Area unless otherwise indicated. For service outside Primary Rate Area, see Mileage Rates, Section 3.

*Opportunity Exchange—Two mile radius from central office.

Farmer Line Service (See Section 3), each station $15.00 per year.
Issued: October 2, 1922. Effective: November 1, 1922.
Cancels and Supersedes Exchange Rates Schedule effective April 1, 1919.
G. A. Walker, Assistant Secretary.

W. D. P. W. No. 3, Section 2

The Home Telephone and Telegraph Company of Spokane

Exchange Rate Schedule—Semi-public

Private Branch Exchange Service

Hotels desiring intercommunication between guest rooms stations and management stations and exterior service for both guest room and management stations shall be furnished semi-public private branch exchange service subject to the following conditions:

[fol. 31] (a) The hotel proprietor is required to become and act as the telephone company's agent in furnishing and selling telephone service to guests.

(b) The hotel agreeing:

(1) To charge the authorized rates for all telephone service rendered to guests and patrons.

*25¢ per month additional.

(2) To collect for the telephone company at the established rates for exchange and interexchange service the charges incurred by patrons and guests and to remit such charges to the telephone company.

(3) To maintain service at proper standards.

(4) To furnish all operating at the private branch exchange switchboard for the transmission, supervision and recording of messages sent to the central office from the private branch exchange system.

(c) The telephone company agreeing:

(1) To furnish facilities and exchange service in accordance with the following schedules, and interexchange service at published rates.

(2) To pay the hotel a commission on exchange interexchange messages originating at guest room and lobby stations and charged to the hotel.

Switchboard with battery power ringing circuit, position dial, switchboard telephone, each position:

	Rate per month
Cordless type	$3 00
Non-multiple cord type:	
10 lines or less in use	5 00
11— 30 lines in use	6 00
31— 60 lines in use	7 00
61—100 lines in use	8 00
101—150 lines in use	9 00
151—200 lines in use	10 00
201—260 lines in use	11 00
261—320 lines in use	13 00
Multiple cord type:	
Each position with not to exceed one multiple jack per line	15 00
[fol. 32] Each additional strip of ten multiple jacks or portion thereof	30

(a) Stations in hotel office and other locations on premises in which switchboard is located for the exclusive use of the hotel management:

		Rate per month
Each station without dial	Wall Set	1 00
	Desk Set	1 25
Each station, with dial	Wall Set	1 25
	Desk Set	1 50

Stations outside premises in which switchboard is located, see Mileage Rates—Section 3:

(b) Stations in guest rooms and lobby:

Each station, without dial	Wall Set	50
	Desk Set	75
Each station, with dial	Wall Set	75
	Desk Set	1 00

Stations furnished in hotel lobbies connected to the switchboard attended by the hotel operator shall be provided with coin boxes (post-payment type) provided they are distinctly placarded as hotel telephones so as to be distinguished from the telephone company's regular public telephone station. Stations without coin boxes may be furnished at the hotel desk for the convenience of visitors inquiring for guests when restricted to interior use. Any additional facilities that might be required with such stations, such as booths, coin boxes, switchboards, etc., to be furnished and charged the hotel at regular rates.

(c) Trunk lines to central office for use in connection with stations in hotel office and other locations for the exclusive use of hotel management.

Outgoing trunk lines only.

Individual line business unlimited rate.

Tie lines between separate switchboards—See Mileage Rates, Section 3.

Bothway trunk lines to central office for use in connection with stations in guest rooms and lobby and for all incoming messages to be furnished without charge to meet traffic requirements.

The rate for each local exchange message originating at stations in guest rooms and lobby and passing through the hotel private branch exchange switchboard to the cen [fol. 33] tral office shall be five cents except that in those cases where the additional service rendered the public as the hotel warrants, a rate of ten cents for each of these local exchange messages may be charged when applied for by the hotel and accepted by the Telephone Company.

The mechanical or electrical design of the private branch exchange will be such that guest room and lobby stations cannot be connected to the outgoing trunk lines provided for the exclusive use of the management.

If the switchboard is to be installed outside the primary rate area, see Mileage Rates, Section 3.

Issued: October 2, 1922. Effective: November 1, 1922. Cancels and Supersedes Exchange Rate Schedule effective April 1, 1919.

G. A. Walker, Assistant Secretary.

[fol. 34] EXHIBIT "C"

BEFORE THE DEPARTMENT OF PUBLIC WORKS OF WASHINGTON

No. 5344

DEPARTMENT OF PUBLIC WORKS OF WASHINGTON, Complainant,

vs.

THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY and THE HOME TELEPHONE AND TELEGRAPH COMPANY OF SPOKANE, Respondents

Order Relating to Valuation of the Home Telephone and Telegraph Company of Spokane

General Statement

This matter arose thru the necessity for determining the valuation of the telephone property of The Home Telephone and Telegraph Company of Spokane (hereinafter referred to as the respondent) as a step in the department's

state wide investigation of the telephone situation initiated by its complaint in this cause dated January 21, 1922.

Hearings in this cause, pursuant to notice duly given, were held before the department in Olympia, December 18, 1922, and in Spokane on January 22, 1923, and February [fol. 35] 28, 1923, at which hearings the department, the City of Spokane, the respondent and other parties were represented, witnesses were sworn and examined, documentary evidence was received, briefs being submitted and the department now being fully advised in the premises makes and enters the following findings of fact and order:

Findings of Fact

I

That The Home Telephone and Telegraph Company of Spokane was organized January 19, 1905. As of June 30, 1922, the date to which all of the following findings refer unless otherwise specifically mentioned, it is found to be owning and operating the telephone exchange plant within the City of Spokane and the rural territory immediately adjacent thereto, together with certain toll lines and facilities within the City of Spokane whereby respondent's subscribers may be connected to the toll lines of the Pacific Telephone and Telegraph Company at the city boundaries.

II

The respondent by means of the property owned and operated by it renders telephone service to the citizens of Spokane for hire and it is therefore a public service com- [fol. 36] pany subject to the laws governing the regulation of all such companies by this Department.

III

For a time prior to 1915 two telephone companies operated in Spokane, one, the respondent, known as the "Home" or "Independent" company and the other, the Pacific Telephone and Telegraph Company, sometimes referred to as the "Pacific" or "Bell" company. During the year 1914 the Pacific Company acquired the capital stock of the Home Company and on January 18, 1915, sold its

Spokane properties to the latter. The consideration in this transaction was as follows:

Thirty year 5% 1st Mortgage Bonds of the Home Company	$1,338,000 00
6% Promissory Note of the Home Company	1,147,927 66
Cancellation of Pacific Company indebtedness to the Home Company	329,600 00
Total	$2,815,527 66

The property conveyed by the Pacific Company is subject to a mortgage given to secure an issue of bonds of the Pacific Company amounting to $35,000,000. The proportion of such indebtedness secured by the property conveyed was $1,500,000. The two properties were consolidated with the result that since 1915 only one company, the respondent, has given telephone service in Spokane. The Pacific Com- [fol. 37] pany, thru its stock ownership of the Home Company, controls the operations of the respondent. In practical effect this situation places Spokane in the relation of an exchange of the Pacific Company.

IV

The cost of construction and equipment of the property embraced in the fixed capital accounts as derived from the books and records of respondent is $3,946,642.74. This figure differs from the amount now carried by the respondent on its books, which with minor adjustments is $3,467,675.01 and was obtained by adding the net additions since January 1, 1915, to a starting figure as of that date composed of the full book value of the Fixed Capital Accounts of the Home Company plus the "Structural" or "Physical Condition" book value of the Pacific Company. The first figure stated above is derived from a starting figure as of the date of the consolidation composed of the actual book cost figures of the Fixed Capital Accounts of both companies. An amount of $2,116,247.69 carried by the respondent as "Miscellaneous Investments" is not considered in the above figures. The amount of $3,946,642.74, above stated, embraces all of the Fixed Capital Accounts, both exchange and toll, representing property owned by the respondent both used and not used for the public convenience.

[fol. 38] It therefore includes certain items of plant acquired in the consolidation, that should be eliminated from consideration in a rate base as not being used for the public convenience. This non-used plant will hereinafter be itemized in detail.

V

The present cost of construction, or what is the same thing, the cost of reproduction, of the respondent's telephone property used and useful for the public convenience, is $6,900,000. This amount was arrived at by applying to an actual field inventory of plant units embraced in the Fixed Capital Accounts as of June 30, 1922, unit prices derived from a price trend study over a principal construction period of three years, subsequent to the date of the inventory.

VI

The cost of reproduction of the property embraced in the fixed capital accounts, less accrued depreciation is $5,900,000. The property is found to be in approximately eighty-five per cent physical condition.

VII

The outstanding capital stock of respondent, all of which, with the exception of directors qualifying shares, is owned [fol. 39] by the Pacific Telephone and Telegraph Company, amounts to a par value of $1,250,000, consisting of 12,500 shares of a par value of $100 each. The market value of this stock cannot be ascertained, there being no recent transactions to indicate its value.

VIII

The funded debt of respondent consists of an issue of First Mortgage 5 per cent, 30 Year Gold Bonds, to the par value of $3,000,000. There is no evidence to indicate the market value of these bonds.

IX

The respondent has never paid any dividends on its capital stock.

X

As indicating the earning capacity of the respondent it is found that for the first six months of the year 1922 the telephone operating revenues were $607,131.64 and for the same period the telephone operating expenses, taxes, uncollectible revenue, and license contract payment as shown on the company's books amounted to $542,576.22.

[fol. 40] XI

The territory served by respondent comprises 43.7 square miles, containing a population of approximately 124,580. The company serves 31,257 exchange stations. The density of population is 285.2 per square mile and the percentage of telephone development (ratio of stations to population) is 25.11 per cent. The use of the telephone, as indicated by the number of calls per capita per year, is 490.56.

XI

We find that the expenditures made by the respondent and its predecessors were such as were justified by the then existing conditions and conditions that might reasonably be expected in the immediate future. Likewise, the money expended has been reasonable for present needs and for the needs of the immediate future.

The property as it is found at this date is the result of the merger of two telephone plants as described in Finding III, and in view of that fact it is inevitable that some duplications of facilities would be found. During the period elapsing since consolidation most of these duplications have been eliminated. However, at the present time it is found that certain property, the book cost of which is included in the amount stated in Finding IV, is either not useful in the [fol. 41] public service or is not at the present time used for the public convenience. The land and buildings comprising old automatic offices B and C, the value of which, not including omissions but including interest during construction, is $12,020.01, are not and cannot be used in the public service. They are therefore excluded from the rate base which will be hereinafter found.

Certain underground plant was found not in use at the

time of the inventory and a portion of this plant is so situated that it is admitted by the company it will never be used in the public service. The following table shows the items of plant just described:

Item	Potentially useful	Not useful
Exchange Underground Conduit duct ft	172,882	8,320
Manholes, number	78	7
Exchange Underground, Cable, wire Mi.	1455.50	0

The value of the foregoing "not useful" plant excluding omissions but including interest during construction, is $5,025.63, which makes a total of $17,045.64 worth of property included in the company's fixed capital accounts which should be eliminated as not now and not likely to be useful in the public service.

[fol. 42] The value of the foregoing underground plant which is classified as "potentially useful in the public service" is $109,866.50. From the evidence submitted we find that approximately $20,000.00 worth of this plant should be regarded as properly includible in the rate base since it is in the nature of a reasonable surplus of plant which prudence dictates that all utilities should have. The balance, or $89,866.50, should not be included in a rate base fixed as of June 30, 1922, but the company is entitled to have such portions of this plant in excess of the $20,000.00 before mentioned as may in the future be placed in active service, included in subsequent rate bases. The facts with respect to this matter can be determined when necessary by using the detailed inventory of this plant to be found in the exhibit submitted by our engineers.

XIII

The respondent submitted what it designated an "Actual Performance Appraisal" of its properties. This is the same method of appraisal followed in the state wide valuation of the Pacific Company on which an order was issued in Cause No. 1810 1825 in 1916. The inventory from which the appraisal was made was carefully checked by our engineers and the unit prices applied to the inventory in order to arrive at the appraisal amounts were likewise

checked. These unit prices may be broadly described by the [fol. 43] term "Historical Prices." They are derived from an analysis of the cost records of the work actually done by the company in constructing the property being appraised. They are actual performance costs applying to the greater portion of the units covered by the inventory. Hence an appraisal on this basis should agree closely with the book cost of property. Excluding the respondent's allowance for omissions from the actual performance appraisal, it is found that it is lower than the adjusted book cost of property by a relatively small amount.

There was some contention over the allowance of an item termed "Omissions" included by the respondent in its appraisal figures. The amount involved is $74,587.65, of which $318.69 relates to the non useful property and $2,198.13 relates to the potentially useful property, all of which is listed in Finding XII, and which the company estimates should be allowed for omitted items. The Department's engineers took the position that a thorough check of the inventory had disclosed that it was accurate to a high degree and that the method of deriving unit prices fully covered any contingencies, therefore this item could reasonably be excluded, and it is excluded from the actual performance appraisal figures and rate base in this order.

The cost of construction and equipment of the property embraced in the fixed capital accounts, estimated by the [fol. 44] company on the actual performance basis not including the non-useful property but including the potentially useful property is as follows:

Intangible Capital:	
Organization	$1,200.00
Exchange Plant:	
Exchange Right of Way	10,087.59
Land	121,451.68
Buildings	433,653.17
Central Office Equipment	665,990.38
Station Apparatus	191,237.70
Station Installations	167,877.82
Interior Block Wires	6,634.73
Private Branch Exchanges	168,905.84
Booths and Special Fittings	1,965.93
Exchange Pole Lines	376,027.78
Exchange Aerial Cable	438,855.92
Exchange Aerial Wire	206,351.54
Exchange Underground Conduit	533,544.19
Exchange Underground Cable	391,859.06
Interest During Construction	47,031.73
Total	$3,761,475.06
Toll Lines:	
Toll Right of Way	175.24
Toll Pole Lines	24,704.52
Toll Aerial Wire	23,827.53
Toll Underground Conduit	205.33
Toll Underground Cable	25,371.90
Interst During Construction	1,099.41
Total	$75,383.93
[fol. 45] **General Equipment:**	
Office Furniture and Fixtures	28,971.27
General Store Equipment	155.28
General Stable and Garage Equipment	29,338.04
General Tools and Implements	13,357.37
Total	$71,821.96
Grand Total	$3,909,880.95

XIV

Some of the amounts stated in fixed capital accounts of respondent are not satisfactory as indicating the actual or true cost of the property included thereunder. The actual performance appraisal accounts as listed in Finding XIII are believed to indicate reliably the facts as nearly as they may be determined and respondent may, if it elects and obtains the necessary permission from the Interstate Commerce Commission, adjust its fixed capital accounts and set them up in accordance with the values in Finding XIII.

XV

The Working Capital, as distinguished from Fixed Capital, required by respondent in conducting its business, amounts, as an average for the first six months of 1922, to $68,867.74. This amount is made up of accounts as follows:

[fol. 46] Cash	$10,628 60
Employees Working Funds	6,091 83
Due from Subscribers and Agents	36,267 91
Materials and Supplies	15,879 40
Total	$68,867 74

"Cash" includes the amounts of current funds available for use on demand. "Employees Working Funds" include amounts advanced to employees from which expenditures are made and subsequently accounted for. "Due from Subscribers and Agents" includes amounts due the company on account of services rendered. "Materials and Supplies" include the cost of unapplied material, including the value of materials temporarily in use but not charged out in the company's accounts and other supplies and approximate charges applicable thereto.

The foregoing amounts are reasonable and the total should be included in the Rate Base upon which respondent is entitled to earn a reasonable return.

XVI

The item of Construction Work in Progress as of June 30, 1922, amounts to $3,117.81. This amount should be in-

cluded in the Rate Base, but due allowance in computing a rate of return must be made by treating the accruals for interest during construction as a part of Income, adding the same to Operating Income before computing the rate of return.

[fol. 47]

XVII

All of respondent's property is located within the State of Washington. Such interstate business as it transacts is toll or long distance business over the lines of other telephone and telegraph companies and it is not feasible to make any segregation of its operations as between intrastate and interstate business.

XVIII

The respondent submitted an exhibit to show that the "Fair Value" of its property was $5,500,000. The exhibits of the Department's engineers and experts for the City of Spokane discussed "Rate Bases" ranging around $4,000,000 and lower. Counsel for the City of Spokane, in his memorandum on the valuation of this property analyzes the exhibits of his experts and contends for the following formula to determine the rate base:

To the value of the Pacific (Manual) Company's property fixed by the Commission as of December 31, 1914—

Add the book accounts relating to the Home (automatic) Company's property when the plants were consolidated.

Add net additions to plant, cash, employees working funds, and materials and supplies.

Deduct value of property not actually in use.

[fol. 48] This gives him a figure of $3,864,081.51 which he states is the "actual investment of the company in use." He then assumes the property to be in 90 per cent condition from which he obtains $3,477,673.36, which is the amount he contends for as the rate base.

The Department's engineers submitted an exhibit which, at page 13, shows a rate base using the same formula. The amount arrived at by using the figures of our engineers which differ somewhat from those of counsel, eliminating the nonuseful property and all but $20,000 of the poten-

tially useful property, is $3,958,081.66. This amount includes working capital and construction work in progress.

The method of using the depreciated value of the actual investment in property advocated by counsel for the City of Spokane has never been adopted by this Department, nor so far as we are aware, do other regulatory bodies regard it with favor. The "cost of reproduction less depreciation" method is used by some, and with some reason as indicating—on a purely physical basis—the "present value" of a property. It has been previously found herein that this amount in this case is $5,900,000. But to our mind the determination of a rate base is a broader problem, including as it does, a variety of factors that must be given consideration. We are of the opinion that there [fol. 49] is nothing in the record to justify us in departing from our usual and well established procedure in weighing the several matters and things prescribed by our Public Service Commission law as affecting value. All of these, which are ascertainable from the record, have been set out in the foregoing findings; wherefore, after giving due consideration to all of the matters and things specified by law as tending to show the value of the property used by the respondent for the public convenience, said value is found to be $3,892,000.00 as of June 30, 1922.

Order

From a consideration of the foregoing facts, the Department concludes and its order is that the value of respondent's property used for the public convenience in rendering telephone service in Spokane as of June 30, 1922, be, and the same is hereby fixed at $3,892,000. Upon this value respondent is entitled to earn a reasonable return, and said value shall hereafter, with net additions, be used as the rate base for this utility, to which may be added the value of underground plant hereafter placed in actual use, after such value exceeds the amount of $20,000 herein allowed.

[fol. 50] Witness the Department of Public Works of Washington this 31st day of March, 1923.

The Department of Public Works of Washington, by E. V. Kuykendall, Director. Hance H. Cleland, Supervisor of Public Utilities. Frank R. Spinning, Supervisor of Transportation.

Attest: J. H. Brown, Secretary.

[fol. 51]

EXHIBIT "D"

Findings of Fact, Order, and Opinion, Cases Numbers 4902 and 5344

(Majority Opinion)

BEFORE THE DEPARTMENT OF PUBLIC WORKS OF WASHINGTON, DIVISION OF PUBLIC UTILITIES

Nos. 4902 and 5344

THE DEPARTMENT OF PUBLIC WORKS OF WASHINGTON EX REL. The City of Seattle, The City of of Spokane, The City of Tacoma, Washington Hotel Men's Association, Seattle Chamber of Commerce, The Port of Seattle, King County, Washington, Tacoma Chamber of Commerce, Complainants,

vs.

PACIFIC TELEPHONE AND TELEGRAPH COMPANY AND HOME Telephone and Telegraph Company of Spokane, Respondents

THE PUBLIC SERVICE COMMISSION OF WASHINGTON Complainant,

vs.

PACIFIC TELEPHONE AND TELEGRAPH COMPANY, Respondent

Findings of Fact, Order, and Opinion

History of the Case

On October 29, 1921, the Department received from the King County Legislative Federation and the Woman's

[fol. 52] Civic Club of Seattle a petition wherein they requested an investigation and revision of the rates of the Pacific Telephone and Telegraph Company in Seattle and King County. Thereupon the Department advised them that a determination of the telephone rates for Seattle and Kings County could only be made, legally, after the filing of a formal complaint, and investigation and study of the entire system of the Pacific Telephone and Telegraph Company in the state of Washington, the holding of public hearings and the entry of written findings of fact and order, but that the Department would proceed to that end. Accordingly, after some preliminary preparation and on January 21, 1922, the Department prepared, filed and served its formal complaint challenging the reasonableness of the rates, rules, regulations and contracts of the Pacific Telephone and Telegraph Company and the Home Telephone and Telegraph Company of Spokane (the latter being an associate or subsidiary company of the Pacific Company).

The Department's engineering and accounting staff, was forthwith directed to proceed with and to make, in cooperation with engineers and accountants employed by the cities or other interested complainants, a thorough and complete analysis, investigation and report on all matters which could and should be considered in a final determination of the matter before the Department.

[fol. 53] Concurrently with the filing of the complaint, a letter, with a copy of the complaint enclosed, was directed to the Mayor, Council or Commission and City Attorney in each and every city and town in the state served by the two telephone companies mentioned, calling attention to the fact that the proceeding and investigation had been instituted, and asking co-operation in the investigation.

March 3, 1922, the City of Seattle filed its complaint in this case with practically the same allegations as those found in the Department's complaint, except that, in addition thereto, the city prayed the issuance of a general reparation order on the ground that the existing rates were illegal.

On or about October 1, 1922, the City of Spokane secured the services of Messrs. Hardinger and Ridley. These men, together with our own engineering and accounting staff,

worked continuously upon this investigation until the time of the hearing. The City of Tacoma made available for checking with our engineering staff, Messrs. Gray and Towne of its electrical department.

On September 20, 1922, the respondent telephone companies filed with the Department exchange rate schedules proposing revised increased rates applicable to all exchanges of those companies in the State of Washington. [fol. 54] On September 24, 1922, the Department issued its order suspending the effective date of these rates for the full statutory period and directing that the company file for the consideration of the Department a toll rate schedule conforming in principle with their pre-war toll rate schedule.

On September 28, 1922, the City of Spokane filed its complaint challenging the reasonableness and the legality of the proposed exchange rate schedule.

On October 5, 1922, the telephone companies filed the toll rate schedules as directed, and concurrently therewith filed with the Department a withdrawal and cancellation of their proposed exchange rate schedules, except as applied to the cities of Seattle, Spokane and Tacoma.

Subsequently, various complaints and letters were received by the Department relative to the proposed increase, comprising some seven hundred and fifty individuals, corporations and associations. To each of these, a personal letter was addressed by the Department, enclosing a copy of the complaint and suspension order, calling attention to the investigation under way and inviting the writer of the letter or signer of the petition, to be present at hearings subsequently to be held.

On December 14, 1922, the Washington Hotel Men's Association filed its complaint protesting the change proposed [fol. 55] to be made by the companies in rates particularly applicable to hotels.

On December 18, 1922, after due notice to all parties, the first hearing in this case was held in the City of Olympia, at which time original evidence of all parties relative to matters of valuation was submitted and some cross-examination of the witnesses had. An adjournment was taken to January 22, 1923, at Spokane, January 24th at Seattle, and January 29th at Tacoma, at which times all witnesses

who had testified on valuation were present for cross-examination upon the testimony given in the original hearing. Following the cross-examination of these witnesses, the telephone companies were required to submit proof in support of their proposed rate increases, and some cross-examination was had of these witnesses in each instance.

At the conclusion of the January hearings, an adjournment was again taken to February 23rd at Seattle, February 26 at Tacoma and February 28th at Spokane. At these latter hearings, all rate witnesses who had testified at the January hearings were present for cross-examination, and upon the conclusion of that cross-examination the cities, the Washington Hotel Men's Association and others offered their proof as opposing that of the companies, and the Department's chief engineer submitted a report embracing [fol. 56] the results of the investigation made by himself and staff and the matter was then submitted for determination.

All hearings, except the one held at Olympia, were held in the assembly room of the respective commercial clubs or chambers of commerce in each of the three cities, Seattle, Spokane and Tacoma, and in each instance the secretary of the chamber of commerce or commercial club was notified of the time and place of the hearing, and request made for the use of their assembly room.

In addition to the legal notices sent to the parties of record, the Department in each instance, without being required by law so to do, some ten days prior to each hearing, addressed seven hundred and fifty personal and individual notices to all parties who had addressed us by letter or petition upon the subject of telephone rates, calling their attention to the time and place of the hearing and to the matters to be considered at that time and place.

At the hearings in the cities of Tacoma and Spokane, some thirty-five or forty business and professional men appeared and showed the effect of the company's proposed rates in their individual cases.

At all of the hearings, each of the cities, Seattle, Tacoma and Spokane, was represented by its corporation counsel, engineers and accountants.

[fol. 57] All these complaints were consolidated for the purpose of hearing and the hearings were joint hearings

under the administrative code, requiring a joint decision by the Director of the Department and the Supervisor of Public Utilities and the Supervisor of Transportation.

From a careful consideration of the record and being advised as to the law, we enter the following findings of fact (with a discussion of each.)

[fol. 58] Findings of Fact

I

Rate Base

Finding:

The value of the telephone properties of the Pacific Telephone and Telegraph Company in the state of Washington, including the Spokane Exchange, used and useful in public service, was, as of June 30, 1922, $32,108,853.76, which amount is fixed as the rate base as of that date.

Discussion:

The respondents in this case have contended for a value (termed by them fair value) in the amount of $40,000,000. This contention is fully answered, to the contrary, by our own Supreme Court in State ex rel. Spokane Gas Light Company v. Kuykendall, 119 Wash. 107.

Our discussion of the Spokane Exchange valuation has been fully covered in separate findings and order. On account of change of ownership of a portion of the property and the consolidation of two systems, the Spokane plant was of necessity treated in an original valuation proceeding.

As to the value of the Pacific Company's plant in Washington, the procedure was merely to bring up to date the [fol. 59] valuation made in 1914 by the Public Service Commission, adding thereto the net additions and betterments from December 31, 1914, to June 30, 1922.

In these findings and this order, all of the property of the Pacific Telephone and Telegraph Company and the Home Telephone and Telegraph Company of Spokane will be treated as one system and the property in Spokane will be treated as an exchange of the Pacific Telephone and

Telegraph "system." Technically, the Home Telephone and Telegraph Company of Spokane is a separate entity, but it is common knowledge that it is maintained as a separate entity for franchise purposes only. All of the stock of the Home Company, except a few directors' qualifying shares, is owned by the Pacific Company and for all practical purposes the Spokane plant is in fact an exchange or part of the Pacific System just as are Seattle and Tacoma; therefore, the valuation made of the Spokane Exchange is treated as an integral part of the state-wide system and the rates to be fixed herein will bear the same relation to the system as do the rates for Seattle and Tacoma.

Due consideration has been given to the items "Construction Work in Progress" and "Due from Subscribers and Agents," and we are of the opinion that these two [fol. 60] items should properly be included in the rate base and in the amount above set out they have been so included.

The Public Service Commission of Washington, in its order in Causes 1810-1825, placing a value for rate making purposes upon the properties of the Pacific Telephone and Telegraph Company in the State of Washington, did not allow as an element of value the item of "Due from Subscribers and Agents." Investigation in the present case disclosed the fact that the amounts shown in the applicants' exhibits and in the report of the Department's engineer as "Due from Subscribers and Agents" represent balances due from subscribers and agents for services rendered previous to the dates as of which the balances were taken and do not contain any amounts representing advance billing. Such accounts receivable are a recognized element of value for rate making purposes and it has always been the practice of this Department to treat them as such. There appears to be no reason for it to depart from its practice in this case.

Some contention was made during the course of the hearing relative to the exclusion of certain properties from the rate base, particularly in Seattle, where a large development has been made by the Pacific Company during the past few years. This property is covered by the account "Construction Work in Progress" which, being a balance

[fol. 61] sheet account, is not ordinarily grouped with the fixed capital accounts in arriving at a rate base. It is our opinion enlarged on in the following discussion, that "Construction Work in Progress" should be included in the rate base.

The Department's engineers, in the first volume of their report, dealing with the rate base, contended that "Construction Work in Progress" should not be included in the rate base, giving as a reason the fact that a utility is permitted to capitalize interest upon funds employed in construction work and that to include "Construction Work in Progress" in the rate base would make possible a double earning during the construction period upon the same investment. In the second volume of their report, the Department's engineers modified their position to the point of including "Construction Work in Progress" in the rate base but, as a compensating factor, including in operating income the interest accrued during the construction period. The reasons for their change of position, as stated on pages 5 and 6 of volume two of their report, are as follows:

"A review of the evidence received at the first hearing in the present case, concerning the proper treatment of construction work in progress, has led to the conclusion that the extreme views as to this factor have been presented by the Company on one hand and by the Department's engineers on the other. Construction work in prog- [fol. 62] ress was included in the rate base by the company, and excluded from the rate base by the Department's engineers, without consideration having been given by either to all of the facts which it is believed are pertinent to a consideration of the ultimate effect upon the rate base and upon operating income. Under the method proposed by the Company, no consideration is given to the interest earnings of funds employed in construction work in progress; while, under the method first proposed by the Department's engineers, consideration was not given to the fact that, if the Company were not permitted to earn on funds employed in construction work, it must be permitted to capitalize interest during the entire construction period between the initiation of the work and the date of its actually coming into service. The effect of this, particularly

in the case of Seattle, where an extremely large construction program is now being carried on, would be to pyramid the rate base and add to the burden of the rate payer during the entire future life of the plant."

Funds employed in construction work are as fully devoted to the public service as are funds invested in completed plant, in materials and supplies, or in the cash required to meet current expenditures. The necessity of an allowance for cash, materials and supplies, and other items of working capital, is recognized by all regulatory bodies and there is no question as to the propriety of permitting an earning upon these items in their final form when they appear as additions to the fixed capital accounts. Since "construction work in progress" represents nothing more [fol. 63] or less than cash and materials and supplies in their transitional stage between working capital and completed plant, it seems as clearly entitled to inclusion in the rate base as it was as working capital or as it will be as completed plant.

There is, however, a further factor in this consideration, which is "Interest during Construction." Funds employed in construction work are entitled to a fair earning. If the funds be borrowed, the creditor is receiving an earning and the utility is suffering no loss since it is permitted to capitalize the interest it pays out. This capitalization creates a value upon which the utility is permitted to earn and which presumably can be sold if the plant changes owners. If the utility capitalizes interest on its own funds there is an actual increase in its surplus. These facts must be recognized when considering the propriety of including "Construction Work in Progress" in the rate base.

The rate of return from operations seldom coincides with the rate at which interest during construction is capitalized; furthermore, the applicant does not capitalize interest upon routine construction work requiring less than one month for completion. Therefore, the most equitable method of treatment appears to be to include "Construction Work in Progress" in the rate base and to include the interest ac- [fol. 64] cretions with operating income, which method acts as an automatic governor to compensate the rate payer, if the rate of capitalization of interest be more, and the

company if it be less, than the rate of return from operations.

II

Depreciation

Finding:

We find that the annual depreciation charge should be reduced from approximately 6 per cent to 3½ per cent for the period of two years from April 1st, 1923.

Discussion:

One of respondents' engineers testified that "depreciation is the sum annually set aside to replace property either worn out or become obsolete in service. In other words, it is the sum that is set aside which, at least theoretically, will keep the plant up to service standard, and keep the dollar whole that is in the business."

Under this view, if a utility investment of one million dollars depreciates in value to $900,000.00, the just amount of depreciation reserve would be $100,000.00.

[fol. 65] Stated in another way, the depreciation reserve should at all times approximately equal the difference between the original value and the present depreciated value of the property.

The respondents have not furnished any statement of debits against depreciation reserve segregated as to the State of Washington. In a recent twelve-year period, the amount set aside by the Pacific Telephone and Telegraph Company (not limited to the state of Washington) has been $41,212,207.00. The realized depreciation, or the amount withdrawn from the reserve for replacements, has been $20,137,489.00, leaving a balance of $21,074,718.00, less certain expenditures for extraordinary repairs and other unusual items. In other words, the replacement expenditures have been approximately fifty per cent of the amount set aside for depreciation purposes. In percentage it has been about five per cent per annum, with this company as a whole and slightly more than six per cent in the State of Washington for several years past.

At the close of the year 1914, the balance in the depreciation reserve of the company was $10,369,854.00. Prorating

this to State of Washington on the basis of plant values, the balance for Washington was $2,418,457.00. Had the company adopted a three and one-half per cent rate of depreciation at the beginning of the year 1915, and debited the de-
[fol. 66] preciation reserve at the company average of 2.47 per cent, the depreciation reserve as of June 30, 1922, would have been $3,945,493.00, or approximately 16 per cent of the depreciable plant value as of the same date. Taking the actual credits to the depreciation reserve, for Washington, and debiting for current replacements at the above rate of 2.47 per cent the balance in the reserve as of June 30, 1922, should have been $7,711,014.00 or nearly one-third of the depreciable plant value.

We have found the property of respondents in the State of Washington to be about 85 per cent physical condition. Under the view expressed by the witness referred to, the depreciation reserve should be approximately 15 per cent of the depreciable property, where the same is found to be 85 per cent physical condition. Had the company accumulated a depreciation reserve at a rate of three and one-half per cent since 1914, the balance would by now be more than 15 per cent as heretofore shown.

In the above calculations we have used the straight line method. If either the sinking fund or annuity method were used by which interest is added to balances, the surplus would be still greater.

The case of "Re Wisconsin Telephone Company" P. U. R. 1922, B. P. 553, decided by Wisconsin Railroad Commis-
[fol. 67] sion, involved an application of the telephone company for increased rates in the City of Milwaukee. The facts disclosed that the depreciation reserve balance was about one-third of the fixed capital in the Milwaukee exchange.

The commission fixed the rate of depreciation at three and one-half per cent. We quote the following:

"It is evident that the credits to this reserve for the Milwaukee exchange since 1909 have been excessive and that a charge to operating expenses equalling three and one-half per cent of the depreciable property would have, so far as experience at present shows, been ample to supply a safe margin to meet losses on property retired from service in the Milwaukee exchange, to which exchange alone this dis-

cussion relates. The use of three and one-half per cent for the purpose of this case is based upon the assumption that the company is correct in its claim that the charges to the depreciation reserve in the future will of necessity considerably exceed the charges in the past and during the war period."

In this case the evidence satisfies us that the charges to the depreciation reserve in the future will be less than in the past.

Modern telephone equipment is more durable than that of earlier periods.

The buildings, pole lines, and other construction by respondents have in recent years been of a substantial, dur- [fol. 68] able and expensive type, which will depreciate more slowly than earlier construction, much of which has already been replaced.

The addition of these high grade units materially increases the rate base upon which the consumer must pay a return and any saving in the way lessened depreciation should be reflected somewhere in a computation to determine a reasonable rate.

Measured by the facts stated and principles announced in the Wisconsin case supra, the reduction of the depreciation allowance to three and one-half per cent for a test period of two years is amply justified. In the Wisconsin case the reduction was not limited to a specified period.

Another reason which to our mind justifies a trial period is the fact that the Interstate Commerce Commission is now engaged in a study of the problem of depreciation as applied to telephone properties, under the provisions of paragraph (5) of Section 20, of the Interstate Commerce Act.

The first hearing will be held May 1, 1923. The notice of the hearings announces that the straight line, annuity, and sinking fund methods of determining depreciation charges will be investigated. Without conceding that the Interstate Commerce Commission has power to prescribe a method of computing depreciation as applied to telephone properties, [fol. 69] which would be binding upon a state regulatory body in the regulation of purely intra state traffic, we believe that the results of this investigation will be of immense value in arriving at correct methods of determining depreciation and for this reason have limited the rate herein

prescribed to a two year period. The final determination of the I. C. C. should be announced within that time.

We are convinced, that measured by any reasonable rule or theory, the depreciation allowance of the respondents in the State of Washington in the past has been greater than necessary. When the depreciation reserve of any public utility becomes greater than the facts of the particular case justify, we believe it proper for the regulatory body to reduce the depreciation allowance, until the amount of the depreciation reserve reaches a proper level.

We will, therefore, order in this case that the depreciation allowance for the two-year period beginning April 1, 1923, shall not exceed three and one-half per cent per annum on the depreciable property of the respondents.

We are not determining hereby a rate of depreciation to be applied generally, in telephone cases. We are here confronted with the fact that more money has accumulated in this fund than necessary, and we are merely reducing the flow until the proper level is reached.

[fol. 70] III

The Four and One-half per Cent Contract Licensee Revenue, Dr.

Finding:

We find that the Four and One-half per cent Contract between the Pacific Telephone and Telegraph Company and the American Telephone and Telegraph Company is wrong in principle, contrary to public policy and the compensation thereunder should be computed on the per station basis rather than a percentage of revenue. We find a reasonable charge per annum for the services rendered under said contract to be 90 cents per station.

Discussion:

This is a uniform contract required by the American Telephone and Telegraph Company of all subsidiary companies.

Under this so-called four and one-half per cent contract the respondents are obligated to pay the American Telephone and Telegraph Company four and one-half per cent

of substantially all of their gross operating revenue for certain rights and services. We have no power to prevent any public utility from entering into a contract with a parent company to share with it any portion of its profits. [fol. 71] We have the right, however, to say whether such share or any part thereof shall be treated as an operating expense. Even at the risk of differing from our predecessor, The Public Service Commission, we are compelled to say that we are not in sympathy with this kind of business. If the parent company performs any service or furnishes any equipment for which payment should be made, such compensation should be based on the value of the service rendered or the reasonable rental of the equipment furnished rather than upon a percentage of operating revenue. We are opposed to an expense item that arbitrarily increases as the revenue increases.

If an increase in rates is allowed in this case, it means that four and one half per cent of the increase will accrue to the American Telephone and Telegraph Company, and there is no evidence that such company is in need of additional revenue, and the local company will receive no more from the parent company than it is now receiving. This four and one-half per cent contract has been a "thorn in the flesh" in every community where the respondents operate. It gives rise to suspicions of concealment and dishonesty in every hearing in which it is involved. Not having power to annul it we believe the respondents and the American Company owe it to the public to wipe it out and put their dealings with the parent company on the basis of actual [fol. 72] value of the service rendered and on a plane that is understandable to the average citizen. However innocent or meritorious it may be in fact, this contract is an endless source of controversy and misunderstanding. The American Telephone and Telegraph Company has in its employ trained and skilled experts who appear at hearings in which this contract is questioned, and present skillful expositions of its provisions, and undertake to justify its existence and yet public distrust of it has increased rather than diminished. We are aware that some courts and commissions have given it their endorsement but after careful consideration we cannot do so. We believe that a utility that has a proper appreciation of the elements that

establish wholesome public relation should take steps to remove such a proven source of discord.

In the case of "In re Michigan State Telephone Company P. U. R. 1923-A, page 764," decided by the public Utilities Commission of Michigan, less than a year ago, the Commission said, "The four and one-half per cent contract between the American Telephone and Telegraph Company and the Michigan State Telephone Company is not a contract between corporations dealing at arms length but one between the superior and inferior—a controlling and a controlled company—the parent company and its subsidiary—the parent company and its child. . The contract is [fol. 73] in effect a contract made by the American Telephone and Telegraph Company as proprietor with the agents of itself as owner of the stock of the Michigan State Telephone Company. The directors and officers of the Michigan State Telephone Company are its directors and officers, because they are made so by a vote of the American Telephone and Telegraph Company as stockholders of the Michigan State Telephone Company."

The Commission further states: "In this case the directors and officers of the Michigan State Telephone Company are elected, directed, influenced and controlled by the American Telephone and Telegraph Company. They exercise not their own judgment and discretion but the judgment and discretion of the American Telephone and Telegraph Company which made and may unmake them. Under the law of this state the four and one-half per cent contract is at least presumatively void."

Substantially the same relations exist between the respondents in this case and the American Telephone and Telegraph Company as existed between the Michigan Company and the American Company. In the same case the Michigan Commission further states:

"Conceding the invalidity of the four and one-half per cent contract, the American Telephone and Telegraph Company is entitled to be reimbursed for the cost of services [fol. 74] performed by it for the Michigan State Telephone Company and to have the integrity of its property used by the Michigan State Telephone Company maintained."

The Commission then proceeds with an exhaustive analysis of the services rendered by the American Telephone

and Telegraph Company which are substantially similar to those rendered under a like contract with the respondents in this case, and concludes that ninety cents per station is a just allowance therefor. The respondents in this case have 179,614 stations. Ninety cents per station would amount to $161,653.00. The amount called for by the four and one-half per cent contract on existing rates is $388,365. In other words, the Michigan Commission makes an allowance of something like two per cent instead of four and one-half per cent as provided in the contract. Without going into a further discussion of the value of the services and privileges paid for by the four and one-half per cent fixed in this contract, we will allow 90 cents per station as an operating expense and disallow the remainder.

A few months ago the Nebraska State Railroad Commission in the case of Re Northwestern Bell Telephone Company, 1923 P. U. R. (Adv. Sheets) p. 165, speaking of this contract said: "Considering the question here discussed it appears to us that the basis of charge as provided in the [fol. 75] contract is fundamentally wrong and condemned specifically by the Supreme Court of the United States. The company applies the percentage to certain gross revenues received by the applicant. The more revenues the more the charge against revenues for the benefit of the American Company, which method of calculation constitutes a circle,—the more the rates the more the charge, ad infinitum."

In the Minnesota Rate Case (Simpson v. Shepard) 230 U. S. 232, Mr. Justice Hughes used the following language:

"The value of the use as measured by rate cannot be made the criterion when the rate itself is in question."

In the case of the City of Houston v. Southwestern Bell Telephone Company etc., U. S. Supreme Court Advance Opinion 1921 22, No. 16, July 1, 1922 p. 539, is cited by respondents as supporting the contract, but the opinion clearly states that the fact that one company owns stock in another "requires close scrutiny of their dealings to prevent imposition upon the community served by the company."

We have tried to give close scrutiny to this contract and have reached the conclusion heretofore stated.

Even if an allowance equal to two and one-half per cent is made as an operating expense under this contract the results would not differ materially.

[fol. 76] The Pacific Company assigns as a reason for not disturbing this contract that the American Telephone and Telegraph Company and its subsidiary concerns have builded their business and accounting methods upon it. In our opinion if this be true they have builded unwisely on a crumbling foundation.

IV

Machine Switching Project

Findings:

We find that the installation of machine switching in Seattle is justified.

Discussion:

Machine switching has been installed to replace manual operation in three of the offices of the City of Seattle. Three other offices will be converted to machine switching in the near future. The testimony of respondents' experts is not clear as to what saving in expense, if any, will be made by the substitution of automatic for manual operation. We are satisfied, however, that a material economy will be brought by the installation of machine switching. In addition to the somewhat unsatisfactory testimony upon this point, we cite an article by a recognized authority on such matters, in Vol. 38, Part 2, of the American Institution of Electrical Engineers, page 1571, where the following statement appears:

[fol. 77] "Telephone exchanges must pay their way. If automatic exchanges do not pay, there would not be any of them left in existence today, for this movement is twenty-seven years old. Five exchanges formerly manual were converted to automatic. They range in size from 2,300 lines and 4,400 telephones to 38,000 lines and 44,000 telephones. The totals for the five were 47,000 lines and 65,000 telephones. The comparison of expenses is as follows:

	Manual	Automatic
Total operating and maintenance expenses per year	$552,600 00	$136,800 00
Average per line per year	11 77	2 92
Average per telephone per year	8 50	2 11

In other words, the operating and maintenance expenses of automatic operation in the case of these five exchanges were about one-fourth the operating and maintenance expenses of manual operation. We do not anticipate such favorable results in a multi-office exchange such as Seattle, but a material saving should ultimately result.

The automatic devices used in the five exchanges above referred to are not those of the Western Electric Company, as installed in Seattle, but it is safe to assume that the Western Electric machine switching devices are superior from the standpoint of economy and efficiency. They are [fol. 78] a later and somewhat costlier product, and we assume that a concern such as the Pacific Telephone and Telegraph Company would not install a device of inferior type.

We must therefore conclude that the installation of the machine switching device in Seattle will on the whole reduce the company's expenses, and our conclusions and order in this case will be made with that assumption in view.

In arriving at this conclusion we have taken into consideration the greater fixed charges which will accrue on the automatic system by reason of the greater capital outlay.

In addition to financial economies, the installation of machine switching to replace manual equipment is further justified for the following reasons:

1. Speed of connection and disconnection.
2. Ease of obtaining connection and disconnection.
3. Accuracy of connection.
4. Voice transmission.
5. Secrecy.

There is also the elimination of some of the faults inherent in manual operation such as:

1. Fluctuations in service.

2. Impairment of service by epidemics, strikes, etc.

3. The mistranslation of calling subscribers desires.

[fol. 79] V

Return

Findings:

The rate of return to be realized under existing rates and by application of the proposed increased rates, is shown in the following income statement adjusted to meet the views heretofore expressed in relation to depreciation allowance and the four and one-half per cent contract.

Statement of Operating Income and Rate of Return

Estimate for Year 1923

Revenues

	Present rates	Proposed rates
1. Exchange Service Revenues	$8,042,437 (a)	$8,424,253 (a)
2. Toll Service Revenues	2,730,000 (a)	2,732,358 (a)
3. Misc. Operating Revenues	308,004 (a)	308,004 (a)
4. Total Tel. Oper. Revenue	$11,080,441 (a)	$11,474,615 (a)

Expenses

5. Ordinary Repairs	$1,514,153 (a)	$1,514,153 (a)
6. Station Removals and Changes	267,785 (a)	267,785 (a)
7. Depreciation	1,070,937 (a)	1,070,937 (a)
8. Traffic Expenses	2,042,731 (a)	2,042,731 (a)
9. Commercial Expense	865,011 (a)	865,011 (a)
10. General & Misc. Expense	254,650 (a)	254,650 (a)
11. Rents	79,956 (a)	79,956 (a)
12. Uncollectible Revenues	35,018 (a)	48,307 (a)
13. Taxes	485,017 (a)	658,057 (a)
14. Licensee Revenue—Dr.	161,653 (a)	161,653 (a)
15. Total Tel. Oper. Expense	$7,357,711 (a)	$7,542,903 (a)
[fol. 80] 16. Operating Income	$3,942,727 (a)	$3,931,712 (a)
17. Int. during Constr.—Accrued	148,122 (a)	148,122 (a)
18. Adjusted Operating Income	$4,090,849 (a)	$4,079,834 (a)
19. Rate Base	34,780,625 (a)	34,780,625 (a)
20. Per Cent Earned	6.01	11.73

Note.—The rate base above is the estimated average plant value for year 1923, plus working capital.

Discussion:

Without calculating any saving by virtue of the installation of machine switching, it is seen that the return under existing rates is approximately 6 per cent.

Whatever saving can be made through the machine switching program, which we feel will soon be substantial, will serve to increase the returns.

If income statements were prepared for several years past adjusted as above, they would show a fair rate of return.

VI

Existing Rates

Finding:

We find that the existing rates are just, fair, reasonable and sufficient.

VII

Proposed Rates

Finding:

We find that the proposed increased rates both toll and exchange, are unjust, unfair, unreasonable, and more than sufficient.

[fol. 81]

VIII

Decrease in Rates

Finding:

The evidence does not justify any reduction in rates at this time.

IX

Reparation

Finding:

The contention made by the City of Seattle for reparation is not supported by the facts or the law and that portion of the complaint should be dismissed.

Petition to Reopen Case

Some two weeks subsequent to the conclusion of all of the hearings in this case, the Seattle Chamber of Commerce, the Port of Seattle and the County Commissioners of King

County, Washington, filed with the Department petitions requesting the reopening of this case. The time for the suspension of the proposed increase in rates in this case expires on April 1, 1923.

In view of the conclusions we have reached the petition to reopen the case will be denied.

Dismissal of Cause No. 4902

Cause No. 4902 entitled The Public Service Commission of Washington v. The Pacific Telephone and Telegraph [fol. 82] Company is an old proceeding relating to facilities and service of respondent in the City of Seattle. There being no reason for continuing the same upon our docket, the matters and things therein alleged being no longer an issue the same is hereby dismissed.

Discussion

This Department has had many disagreeable tasks to perform. During the war period the rising cost of labor and materials made it necessary for us to allow increased rates to many utilities to save them from bankruptcy. In almost every decision we held out a hope if not a promise that when conditions returned to normal and the period of inflation had passed rates would come down. Many utility rates have been reduced, some voluntarily and some by order of this Department, but now comes the respondents when we had dared hope that our predictions might be realized and ask for startling increases. We have sought to pursue a straightforward course doing justice to the utilities and the public regardless of popular clamor. During the war period the Postmaster General increased the rates of respondents during Federal control. These rates automatically expired and the former rates became revived by the return of the telephone lines to private ownership. Our predecessor, the Public Service Commission, permitted [fol. 83] the refiling of the so-called Burleson rates upon one day's notice and they have been in effect ever since though the prices of materials and labor have steadily decreased. The commission was condemned by the press and public for permitting the continuance of these rates. The State of Oregon and other states refused to sanction the

Burleson rates and the general telephone rate level has been higher in the State of Washington than in adjoining states until recently. We believe the commission acted wisely in continuing the so-called Burleson rates.

If we were convinced that the increases now sought by respondent were necessary and warranted by all facts we would permit them and submit to any censure that would follow with the patience that regulatory bodies must in the nature of things exhibit, but we are not so convinced.

Order

Wherefore it is ordered:

1. That the applications of respondents for increased rates be and the same are hereby denied. That the proposed increased rates in their entirety be and they are hereby permanently suspended; that the same shall not become effective, and existing rates shall remain in effect until the further order of the Department.

[fol. 84] 2. That the annual depreciation allowance be and the same is hereby fixed at 3½ per cent on the depreciable property of respondents for the period of two years beginning April 1, 1923.

3. That the compensation to be paid the American Telephone and Telegraph Company under said 4½ per cent contract shall hereafter be computed on the basis of 90 cents per station per annum on the average number of stations.

4. That Cause No. 4902 entitled "The Public Service Commission of Washington v. The Pacific Telephone and Telegraph Company" be and the same is hereby dismissed.

5. That the portions of the complaints seeking reparation or reduced rates be and they are hereby dismissed.

Witness the Department of Public Works of Washington this 31st day of March, 1923.

The Department of Public Works of Washington, by E. V. Kuykendall, Director. Frank R. Spinning, Supervisor of Transportation.

Attest: J. H. Brown, Secretary.

[fol. 85] EXHIBIT "E"

Dissenting Opinion Cases Numbers 4902 and 5344

Dissenting Opinion

For the first time in our association as members of the Department of Public Works, of Washington, formerly the Public Service Commission of Washington, my associates and myself have been unable to agree upon a final order.

The majority opinion in this case contains conclusions upon certain fundamental principles of telephone rates regulation to which I cannot subscribe, and which are wholly at variance with my own conclusions.

In my opinion the record in this case fully sustains the conclusions which are expressed in the minority opinion filed herewith.

Dated at Olympia, Washington, March 31, 1923.

Hance H. Cleland, Supervisor of Public Utilities.

[fol. 86] BEFORE THE DEPARTMENT OF PUBLIC WORKS OF WASHINGTON, DIVISION OF PUBLIC UTILITIES

Nos. 4902 and 5344

THE DEPARTMENT OF PUBLIC WORKS OF WASHINGTON EX REL. the City of Seattle, The City of Spokane, The City of Tacoma, Washington Hotel Men's Association, Seattle Chamber of Commerce, The Port of Seattle, King County, Washington, Tacoma Chamber of Commerce, Complainants,

vs.

PACIFIC TELEPHONE AND TELEGRAPH COMPANY and HOME Telephone and Telegraph Company of Spokane, Respondents

THE PUBLIC SERVICE COMMISSION OF WASHINGTON, Complainant; PACIFIC TELEPHONE AND TELEGRAPH COMPANY, Respondent

Findings of Fact, Order, and Opinion

History of the Case

On October 29, 1921, the Department received from the King County Legislative Federation and the Women's Civic

[fol. 87] Club of Seattle a petition wherein they requested an investigation and revision of the rates of the Pacific Telephone and Telegraph Company in Seattle and King County. Thereupon the Department advised them that a determination of the telephone rates for Seattle and King County could only be made, legally, after the filing of a formal complaint, an investigation and study of the entire system of the Pacific Telephone and Telegraph Company in the State of Washington, the holding of public hearings and the entry of written findings of fact and order, but that the Department would proceed to that end. Accordingly, after some preliminary preparation and on January 21, 1922, the Department prepared, filed and served its formal complaint, challenging the reasonableness of the rates, rules, regulations and contracts of the Pacific Telephone and Telegraph Company and the Home Telephone and Telegraph Company of Spokane (the latter being an associate or subsidiary company of the Pacific Company.)

The Department's Chief Engineer, H. J. Flagg, and its engineering and accounting staff, together with Mr. W. W. Hardinger, a consulting telephone engineer with twenty-seven years' experience in the construction, operation and engineering of independent telephone properties employed by the Department as a special engineer, were forthwith [fol. 88] directed to proceed with and to make, in co-operation with engineers and accountants employed by the cities or other interested complainants, a thorough and complete analysis, investigation and report on all matters which could and should be considered in a final determination of the matter before the Department.

Concurrently with the filing of the complaint, a letter, with a copy of the complaint enclosed, was directed to the mayor, council or commission and city attorney in each and every city and town in the state served by the two telephone companies mentioned, calling attention to the fact that the proceeding and investigation had been instituted, and, that it being a case of unusual magnitude, it was the desire of the Department that the city authorities and their local commercial and other public and civic bodies and organizations co-operate with us in this work, rendering such aid or assistance as possible. These letters and complaints were

5
5

mailed to the authorities of more than one hundred cities and towns.

On March 3, 1922, the City of Seattle filed its complaint in this case with practically the same allegations as those found in the Department's complaint, except that, in addition thereto, the city prayed the issuance of a general reparation order on the ground that the existing rates were illegal. Subsequently and on or about March 31, 1922, the [fol. 89] City of Seattle employed Mr. T. E. Phipps, an experienced rate and valuation engineer, with whom was associated in the preparation of this case, Mr. E. D. Ridley, a well qualified public utility auditor and accountant.

On or about October 1, 1922, the City of Spokane secured the services of Messrs. Hardinger and Ridley, above mentioned. These men, together with our own engineering and accounting staff, worked continuously upon this investigation until the time of the hearing. The City of Tacoma made available for checking with our engineering staff, Messrs. Gray and Towne of its electrical department.

Mr. Ridley and Mr. L. P. Hockett, utility engineer and accountant for the Department, spent several months in San Francisco checking the books, records and accounts of the companies. A thorough check, examination and survey was made in the State of Washington, particularly at Seattle, Spokane and Tacoma. In addition thereto a check and examination of the books, records and accounts of the American Telephone and Telegraph Company in New York and of various companies (including many independent telephone companies) in the reports and records of the Interstate Commerce Commission in Washington, D. C., was made.

[fol. 90] On September 20, 1922, the respondent telephone companies filed with the Department exchange rate schedules, proposing revised increased rates applicable to all exchanges of those companies in the State of Washington.

On September 24, 1922, the Department issued its order suspending the effective date of these rates for the full statutory period and directing that the company file for the consideration of the Department a toll rate schedule conforming in principle with their pre war toll rate schedule.

On September 28, 1922, the City of Spokane filed its complaint challenging the reasonableness and the legality of the proposed exchange rate schedule.

On October 5, 1922, the telephone companies filed the toll rate schedule as directed, and concurrently therewith filed with the Department a withdrawal and cancellation of their proposed exchange rate schedules, except as applied to the cities of Seattle, Spokane and Tacoma.

Subsequently, various complaints and letters were received by the Department relative to the proposed increase, comprising some seven hundred and fifty individuals, corporations and associations. To each of these a personal letter was addressed by the Department, enclosing a copy of the complaint and suspension order, calling attention to [fol. 91] the investigation under way and inviting the writer of the letter or signer of the petition, to be present at hearings subsequently to be held.

On December 14, 1922, the Washington Hotel Men's Association filed its complaint protesting the change proposed to be made by the companies in rates particularly applicable to hotels.

On December 18, 1922, after due notice to all parties, the first hearing in this case was held in the City of Olympia, at which time original evidence of all parties relative to matters of valuation was submitted and some some cross examination of the witnesses had. An adjournment was taken to January 22, 1923, at Spokane, January 24th at Seattle, and January 29th at Tacoma, at which times all witnesses who had testified on valuation were present for cross-examination upon the testimony given in the original hearing. Following the cross-examination of these witnesses, the telephone companies were required to submit proof in support of their proposed rate increases, and some cross-examination was had of these witnesses in each instance.

At the conclusion of the January hearings, an adjournment was again taken to February 23rd at Seattle, February 26th at Tacoma and February 28th at Spokane. At these latter hearings, all rate witnesses who had testified [fol. 92] at the January hearings were present for cross-examination, and upon the conclusion of that cross-examination the cities, the Washington Hotel Men's Association and others offered their proof as opposing that of the companies, and the Department's chief engineer submitted a report embracing the results of the investigation made by himself and staff and the matter was then submitted for determination.

All hearings except the one held at Olympia, were held in the assembly room of the respective commercial clubs or chambers of commerce in each of the three cities, Seattle, Spokane and Tacoma, and in each instance the secretary of the chamber of commerce or commercial club was notified of the time and place of the hearing, and request made for the use of their assembly room.

In addition to the legal notices sent to the parties of record, the Department in each instance, without being required by law so to do, some ten days prior to each hearing, addressed seven hundred and fifty personal and individual notices to all parties who had addressed us by letter or petition upon the subject of telephone rates, calling their attention to the time and place of the hearing and to the matters to be considered at that time and place. The [fol. 36] greater part of these notices were sent to business and professional men in the city of Seattle from whom the greater number of complaints had been received; and it may be interesting to note that although some 2,300 notices of hearings and personal letters were written to these complainants in the City of Seattle, there were (other than attorneys, engineers and accountants appearing directly for parties of record) only seven persons present at the Seattle hearing who offered any statement whatever upon the subject under investigation and consideration, and the only proof offered by these persons was a comparison between their monthly or yearly bills under the old rates and what their bills would be under the company's proposed rates. Of the number who received at least three direct and personal notices and communications concerning the investigation and hearings, many were members of the Seattle Chamber of Commerce, namely one hundred and eight, and at least two were officers of that organization.

At the hearings in the cities of Tacoma and Spokane some thirty five or forty business and professional men appeared and showed the effect of the company's proposed rates in their individual cases.

At all of the hearings, each of the cities, Seattle, Tacoma and Spokane, was represented by its corporation counsel engineers and accountants.

[fol. 94] The investigation and hearings in this case have been the most comprehensive ever made by the Public Service Commission or the Department of Public Works of Washington and have extended over a period of 14 months, during the greater part of which time the Department has been assisted by the engineers and accountants for the cities, who have worked in the spirit of closest cooperation. The Department, through authority vested in it by law, has made available to all parties, all records, books, papers, documents, data and statistics found in the records of both companies, and has in all cases supplied the engineers and accountants for the cities, with all data, records, etc., collected by it from all sources. In fact, the entire investigation and proceeding has been so conducted that (if we may take the liberty of quoting from an interview published in a Spokane paper) Mayor Charles A. Fleming and Corporation Counsel James M. Geraghty of Spokane, stated that they were much pleased with the showing made by the engineering experts employed by the state and the city in opposition to the proposed increase in telephone rates, and that the atmosphere prevailing was something entirely different from anything encountered in former hearings; that the officials of the State Department of Public Works showed a spirit of cooperation with Spokane and [fol. 95] Seattle, and a determination to make a thorough investigation into the telephone situation before taking action.

From a careful consideration of the record and being advised as to the law, we enter the following findings of fact (with a discussion of each).

Findings of Fact

I

Rate Base

Finding:

The value of the telephone properties of the Pacific Telephone and Telegraph Companies in the State of Washington, including the Spokane Exchange, used and useful in public service was, as of June 30, 1922, $32,108,853.76 which amount is fixed as the rate base of that date.

Discussion:

The respondents in this case have contended for a value (termed by them fair value) in the amount of $40,080,080. This contention is fully answered, to the contrary, by our own Supreme Court in State ex rel Spokane Gas Light Company v. Kuykendall, 119 Wash. 107.

Our discussion of the Spokane Exchange valuation has been fully covered in separate findings and order. On ac- [fol. 96] count of change of ownership of a portion of the property and the consolidation of two systems, the Spokane plant was of necessity treated as an original valuation proceeding.

As to the balance of the Pacific Company's plant in Washington, it is merely the bringing up to date of a valuation made in 1914 by the Public Service Commission, adding thereto the net additions and betterments from December 31, 1914, to June 30, 1922.

In these findings and this order, all of the property of the Pacific Telephone and Telegraph Company and the Home Telephone and Telegraph Company of Spokane will be treated as one system and the property in Spokane will be treated as an exchange of the Pacific Telephone and Telegraph "system." Technically, the Home Telephone and Telegraph Company of Spokane is a separate entity, but it is common knowledge that it is maintained as a separate entity for franchise purposes only. All of the stock of the Home Company, except a few directors' qualifying shares, is owned by the Pacific Company and for all practical purposes the Spokane plant is in fact an exchange or part of the Pacific system just as are Seattle and Tacoma; therefore, the valuation made of the Spokane Exchange is treated as an integral part of a state-wide system and the rates to be fixed herein will bear the same relation to the system as do the rates for Seattle and Tacoma.

[fol. 97] Due consideration has been given to the items "Construction Work in Progress" and "Due from Subscribers and Agents," and we are of the opinion that these two items should properly be included in the rate base and in the amount above set out they have been so included.

The Public Service Commission of Washington, in its order in Causes 1810-1825, placing a value for rate making

purposes upon the properties of the Pacific Telephone and Telegraph Company in the State of Washington, did not allow as an element of value the item of "Due from Subscribers and Agents." Investigation in the present case disclosed the fact that the amounts shown in the applicants' exhibits and in the report of the Department's engineer as "Due from Subscribers and Agents" represent balances due from subscribers and agents for services rendered previous to the dates as of which the balances were taken and do not contain any amounts representing advance billing. Such accounts receivable are a recognized element of value of rate making purposes and it has always been the practice of this Department to treat them as such. There appears to be no reason for it to depart from its practice in this case.

Some contention was made during the course of the hearing relative to the exclusion of certain properties from the [fol. 98] rate base, particularly in Seattle where a large development has been made by the Pacific Company during the past few years. This property is covered by the account "Construction Work in Progress" which, being a balance sheet account is not ordinarily grouped with the fixed capital accounts in arriving at a rate base. It is our opinion enlarged on in the following discussion, that "Construction Work in Progress" should be included in the rate base.

The Department's engineers, in the first volume of their report, dealing with the rate base, contended that "Construction Work in Progress" should not be included in the rate base, giving as a reason the fact that a utility is permitted to capitalize interest upon funds employed in construction work and that to include "Construction Work in Progress" in the rate base would make possible a double earning during the construction period upon the same investment. In the second volume of their report, the Department's engineers modified their position to the point of including "Construction Work in Progress" in the rate base, but, as a compensating factor, including in operating income the interest accrued during the construction period. The reasons for their change of position, as stated on pages 5 and 6 of volume two of their report, are as follows:

[fol. 99] "A review of the evidence received at the first hearing in the present case, concerning the proper treatment of construction work in progress, has led to the conclusion that the extreme views as to this factor have been presented by the company on one hand and by the Department's engineers on the other. Construction work in progress was included in the rate base by the company, and excluded from the rate base by the Department's engineers, without consideration having been given by either to all of the facts which it is believed are pertinent to a consideration of the ultimate effect upon the rate base and upon operating income. Under the method proposed by the company, no consideration is given to the interest earnings of funds employed in construction work in progress, while, under the method first proposed by the Department's engineers, consideration was not given to the fact that if the company were not permitted to earn on funds employed in construction work, it must be permitted to capitalize interest during the entire construction period between the initiation of the work and the date of its actually coming into service. The effect of this, particularly in the case of Seattle, where an extremely large construction program is now being carried on, would be to pyramid the rate base and add to the burden of the rate payer during the entire future life of the plant."

Funds employed in construction work are as fully devoted to the public service as are funds invested in completed plant, in materials and supplies, or in the case required to meet current expenditures. The necessity of an [fol. 100] allowance for cash materials and supplies, and other items of working capital, is recognized by all regulatory bodies and there is no question as to the propriety of permitting an earning upon these items in their final form when they appear as additions to the fixed capital accounts. Since "construction work in progress" represents nothing more nor less than cash and materials and supplies in their transitional stage between working capital and completed plant, it seems as clearly entitled to inclusion in the rate base as it was as working capital or as it will be as completed plant.

There is, however, a further factor in this consideration, which is "Interest during Construction." Certainly, funds

employed in construction work are entitled to a fair earning. If the funds be borrowed, the creditor is receiving and earning and the utility is suffering no loss since it is permitted to capitalize the interest it pays out. This capitalization creates a value upon which the utility is permitted to earn and which presumably can be sold if the plant changes owners. If the utility capitalizes interest on its own funds there is an actual increase in its surplus. These facts must be recognized when considering the propriety of including "Construction Work in Progress" in the rate base.

[fol. 101] The rate of return from operation seldom coincides with the rate at which interest during construction is capitalized; furthermore, the applicant does not capitalize interest upon routine construction work requiring less than one month for completion. Therefore, the most equitable method of treatment appears to be to include "Construction Work in Progress" in the rate base and to include in operating income the interest accretions which act as an automatic governor to compensate the rate payer, if the rate of capitalization of interest be more and the company if it be less, than the rate of return from operations.

Rate of Returns—(Earnings)

Findings:

That under the rates applicable during the past seven years the Pacific Telephone and Telegraph Company in the State of Wash[illegible]ton, after paying operating expenses, taxes, licenses to some debtor, and setting aside depreciation, has shown an annual rate of return as follows:

							1-1 to 6-30-22
1915	1916	1917	1918	1919	1920	1921	
1.84%	3.40%	3.31%	3.13%	4.67%	4.08%	3.52%	3.35%
							(annual)

and that said rate of return during the entire period has been unfair, unjust, unreasonable and less than sufficient.

[fol. 102] That the estimated rate of return of the Pacific Telephone and Telegraph Company for the State of Wash-

ington for the year 1923 under the rate proposed by the Companies, computed upon the rate base herein found, will be 9.04%, which would be unjust, unfair, unreasonable and more than sufficient.

That under the rates fixed and allowed by this order, the rate of return will be 7.37 per cent upon the rate base herein established.

Discussion:

It has been a consistent policy of the present members of this Department in all rate cases, where satisfactory service was shown to have been given, to allow a rate of return approximating 8% upon the value or rate base as fixed and determined by the Department. It is admitted by counsel for the City of Seattle that the service is satisfactory. The only direct testimony upon this subject was that of a witness for the City of Seattle, who stated that 8% was a fair rate of return upon money invested in the telephone plant. As testified on cross examination by certain witnesses (telephone users) for the City of Tacoma, a rate of return ranging from 6% to 10% was by them deemed reasonable, should they invest their money, depending upon the nature or class of business in which the investment was made.

[fol. 103] For convenience of study, and to make the manner and method of computation clear, there is here inserted an income statement for the years 1920, 1921, and the first six months of 1922. We will define and discuss each of the items therein. The numbers refer to the corresponding account title on the statement.

[fol. 104] Statement of Operating Income and Rate of Return, Pacific System, State of Washington

	1920	1921	January 1 to June 30, 1922
1. Telephone Operating Revenues	$7,754,052 82	$8,114,245 13	$4,165,420 49
Deductions from Revenues:			
2. Telephone Operating Expenses (excl. Dep.)	4,716,709 05	5,043,458 88	2,573,994 76
3. Taxes Assignable to Operations	690,045 53	543,449 27	262,310 90
4. Uncollectible Operating Revenues	17,321 26	29,028 68	17,961 75
5. Depreciation (on Depreciable Property)	1,177,358 87	1,321,585 78	727,295 13
6. Licensee Revenue—Dr.	327,106 58	342,658 03	173,421 04
7. Total Deductions from Revenue	$6,838,741 29	$7,280,180 64	$3,754,083 58
8. Operating Income	915,311 53	834,064 49	411,336 91
9. Interest during Construction	17,959 48	90,491 52	97,965 71
10. Adjusted Operating Income	$933,271 01	$924,556 01	$509,302 62
11. Rate Base (Incl. C. I. P.)	22,821,159 54	26,232,691 37	30,425,113 89
12. Rate of Return	4 09%	3 52%	3 35%

NOTE.—Line 11—Amounts are average for the period hence do not agree with rate base finding since the latter is of a specific date, namely June 30, 1922.

[fol. 105] 1. Telephone Operating Revenues.—This the total annual revenue arising from the conduct of the telephone business. From this amount, and before any balance is available for the payment of dividends or interest on bonds or other obligations, there is properly deductible Items 2, 3, 4, 5 and 6.

2. Telephone Operating Expenses. (Excluding Depreciation).—This item includes salaries, wages, materials, and all other expenses of operating a telephone plant, except those covered by Items 3, 4, 5 and 6. No interest of any kind is included in any of the items deductible from Telephone Operating Revenues.

3. Taxes Assignable to Operations.—This item includes all federal, state, county and municipal taxes paid by the telephone company.

The Department has heretofore consistently refused the allowance of income tax in all utility matters coming before it. However, in view of recent decisions of the Supreme Court of the United States, federal courts and the Interstate Commerce Commission, we are constrained to reverse our former holding and practice in this regard, and to follow the law as definitely settled by the courts, which is, that federal income tax is properly deductible from operating revenues.

Consolidated Gas Company of New York v. Newton, 267 Federal 231.

[fol. 106] Newton v. Consolidated Gas Company, 42 Supt. Ct. 264.

Galveston Electric Company v. Galveston, 66 Law Ed. 382.

Reduced Rates 1922—I. C. C. 683.

4. Uncollectible Operating Revenues.—This item includes the charges for telephone and other services, which, after a reasonably diligent effort to collect, have proved impracticable of collection. Only uncollectible bills for amounts which have been treated as operating revenues (see above) are included in this account.

5. Depreciations (on Depreciable Property).—Under the system of accounts prescribed by the Interstate Commerce

Commission and adopted by the Department of Public Works, telephone companies operating in the State of Washington are required to establish and include in their yearly and monthly operating expenses, a charge sufficient to cover depreciation of plant due to wear and tear, obsolescence, inadequacy, public demand, extraordinary accidents, catastrophies, etc. These charges are carried to a depreciation reserve, and the costs of all replacements of plant units, instead of being included in the ordinary repairs accounts, are charged against the depreciation reserve. Owing to the fact that the annual depreciation charge must be estimated, there naturally have been some slight differences of opinion as to just how this annual [fol. 107] charge should be estimated, and just about what percentage of plant cost it should be. It is apparent that while the percentage necessary in the case of one exchange may vary to some extent from the percentage necessary in the case of another exchange, due to a possible difference in the character of the physical property contained in each; yet at the same time, there should be no material differences in the annual charges necessary for large telephone systems, involving a number of exchanges, large and small, in different portions of a state, where climatic and other conditions are not the same.

The question here involved and to be determined is as to what reasonable annual percentage should be allowed for depreciation of respondent's plant in this state.

In computing the rate of return, in all statements found herein, annual depreciation has been allowed at a percentage of 5.25%.

The subject of depreciation was covered fully by witnesses for the companies, for the Department and for the City of Seattle, and the percentages recommended by each were as follows:

Companies	5.75%	
City of Seattle	5.88%	(exchange plant only)
Department's Engs.	5.25%	

[fol. 108] In Case No. 4747, Public Service Commission of Washington et al. v. Pacific Telephone and Telegraph Company, decided February 13, 1919, the Public Service Commission of this state approved depreciation for the com-

pany at an annual percentage of 5.72%, and 5.72% was the percentage allowed by agreement with the Federal Government during the period of Federal control of the telephone systems of the United States.

In addition to our finding of depreciation at 5.72% in Case No. 4747, depreciation percentages were allowed by us in the following cases:

Cause No. 5040, City of Port Angeles v. Angeles Telephone and Telegraph Company, Nov. 17, 1920, 5.72%.

Cause No. 5076, Camas Commercial Club v. Camas Telephone and Telegraph Company, February 1, 1921, depreciation allowed 6%.

Cause No. 5127, Commission v. Oregon-Washington Telephone Company, January 4, 1921, rate not stated in order, but 5.72% found in working papers.

There is included herein a tabulation of decisions on depreciation by commissions and courts. There are 112 commission decisions and eight court decisions.

It is found from an analysis of these decisions that the rates for depreciation fixed by the regulatory bodies gen- [fol. 109] erally were considered to apply to the property as a whole, either to the total actual cost or the total reproduction cost, or to the total value. The percentages allowed range from a minimum of 2.29% to a maximum of 10%. In twelve of the cases, the allowance was below 5%; in fifty cases the percentage was from 5% to 6%; in forty case the percentage was from 6% to 7%, while in ten cases the allowance in excess of 7%. The average allowance was 5.972%. It will also be noted that in ninety of the 112 cases reported the depreciation allowance fell between 5% and 7%.

[fol. 110] Tabulation of Cases on Depreciation

Jurisdiction	Citation		Rate fixed
Alabama	PUR1919B	791	5 50
Arizona	PUR1920B	411	6 00
Arkansas	PUR1921B	516	6 40
California	PUR1915F	1014	5 50
California	PUR1922A	853	5 50
California	PUR1922C	97	3 28
Colorado	PUR1917B	198	5 65

Jurisdiction	Citation		Rate fixed
Georgia	PUR1921C	833	5 11
Hawaii	PUR1921B	209	6 80
Idaho	PUR1916C	438	6 07
Idaho	PUR1920E	321	6 00
Illinois	PUR1915D	646	5 00
Illinois	PUR1916B	318	7 00
Illinois	PUR1916D	781	6 58
Illinois	PUR1917A	658	6 00
Illinois	PUR1917B	368	6 00
Illinois	PUR1918B	172	5 50
Illinois	PUR1918E	74	5 50
Illinois	PUR1915E	23	5 00
Indiana	PUR1917F	209	4 50
Indiana	PUR1918C	489	5 00
Indiana	PUR1918E	859	5 00
Indiana	PUR1918E	669	5 00
Indiana	PUR1920C	209	5 00
Indiana	PUR1920C	854	5 00
Indiana	PUR1919E	504	5 00
Indiana	PUR1920A	422	5 00
Indiana	PUR1920B	813	5 00
Indiana	PUR1920D	83	5 00
Indiana	PUR1922E	46	5 00
Kansas	PUR1915B	507	6 00
Kansas	PUR1918C	55	6 50
Kansas	PUR1918C	777	5 72
Kansas	PUR1922A	321	4 36
Louisiana	PUR1922E	86	5 00
Maine	PUR1920C	386	3 32
Maryland	PUR1916C	925	6 25
[fol. 111] Michigan	PUR1921C	545	5 00
Michigan	PUR1921E	308	5 00
Michigan	PUR1923A	30	4 00
Minnesota	PUR1916C	141	8 94
Minnesota	PUR1921C	733	4 50
Missouri	PUR1915C	366	6 50
Missouri	PUR1920E	59	7 00
Missouri	PUR1919A	659	5 50
Missouri	PUR1922A	773	6 00
Nebraska	PUR1915E	57	6 00
Nebraska	PUR1919A	35	6 00
New Hampshire	PUR1918F	592	7 00

Jurisdiction	Citation		Rate fixed
New York	PUR1916B	940	5 80
New York	PUR1920D	529	5 66
North Dakota	PUR1921E	567	6 00
North Dakota	PUR1922E	602	5 00
Ohio	PUR1922A	155	5 00
Oregon	PUR1915F	290	2 39
Oregon	PUR1919D	345	3 55
South Dakota	PUR1915A	562	7 00
South Dakota	PUR1915B	223	7 00
South Dakota	PUR1915E	516	6 00
South Dakota	PUR1916A	364	7 00
South Dakota	PUR1916D	603	6 00
South Dakota	PUR1919B	734	7 00
South Dakota	PUR1922D	769	4 00
Utah	PUR1918C	566	6 50
Virginia	PUR1922A	756	5 50
West Virginia	PUR1921B	97	6 10
Wisconsin	2WRCR	105	3 67
Wisconsin	2WRCR	358	8 00
Wisconsin	2WRCR	427	10 00
Wisconsin	2WRCR	546	7 00
Wisconsin	3WRCR	117	8 00
Wisconsin	3WRCR	412	8 00
Wisconsin	3WRCR	452	8 00
Wisconsin	4WRCR	1	8 00
Wisconsin	4WRCR	259	7 50
Wisconsin	4WRCR	370	7 00
Wisconsin	4WRCR	407	7 00
Wisconsin	4WRCR	414	7 00
Wisconsin	6WRCR	211	8 00
[fol. 112] Wisconsin	6WRCR	419	6 50
Wisconsin	6WRCR	549	6 50
Wisconsin	6WRCR	573	6 50
Wisconsin	7WRCR	428	7 00
Wisconsin	7WRCR	698	7 00
Wisconsin	8WRCR	92	6 50
Wisconsin	9WRCR	383	6 50
Wisconsin	9WRCR	489	6 67
Wisconsin	11WRCR	180	6 50
Wisconsin	11WRCR	402	7 00
Wisconsin	11WRCR	429	6 50
Wisconsin	11WRCR	666	6 52

Jurisdiction	Citation		Rate fixed
Wisconsin	13WRCR	540	6 50
Wisconsin	14WRCR	157	7 00
Wisconsin	14WRCR	594	6 50
Wisconsin	15WRCR	182	9 00
Wisconsin	15WRCR	552	7 00
Wisconsin	16WRCR	402	6 67
Wisconsin	16WRCR	473	6 50
Wisconsin	16WRCR	758	7 00
Wisconsin	PUR1916C	1020	5 00
Wisconsin	PUR1916D	631	6 50
Wisconsin	PUR1917A	439	5 17
Wisconsin	PUR1917C	507	5 50
Wisconsin	PUR1917E	540	6 00
Wisconsin	PUR1919D	909	6 00
Wisconsin	PUR1920C	1019	6 00
Wisconsin	PUR1921E	171	4 58
Wisconsin	PUR1922A	164	6 00
Wisconsin	PUR1922B	91	5 00
Wisconsin	PUR1919F	92	5 21
Wisconsin	PUR1922B	553	3 50
Wisconsin	PUR1922D	368	5 00

The following court decisions also discuss the matter at some length:

Pioneer Telephone Company, Oklahoma, 118 Pac. 363.

Railroad Company v. Richmond, 96 U. S. 521.

[fol. 113] Munn v. Illinois, 94 U. S. 133.

Cumberland Telephone and Telegraph Company v. Louisville, 187 Federal 637.

Cumberland Telephone and Telegraph Company v. Memphis, 183 Federal 875.

Cumberland Telephone and Telegraph Company v. Railroad Commission, 156 Federal 823.

Home Telephone and Telegraph Company v. Carthage, 139 S. W. 547.

Bell Telephone Company v. Houston, Texas, P. U. R. 1922D, 793.

6. Licensee Revenue Debtor (4% Contract).—This is a contract between the American Telephone and Telegraph Company and the Pacific Telephone and Telegraph Com-

pany and the Home Telephone and Telegraph Company of Spokane, whereby the Pacific Company and the Home Company pay to the American Company four and one-half per cent of the gross revenue from four principal classes of service, namely: 1st, Subscribers' Station Revenues; 2nd, Public Pay Station Revenues; 3rd, Private Exchange Line Revenues, and 4th, Message Toll Revenues, less Uncollectible Operating Revenues. The total amount paid by the Pacific Company and the Home Company under this contract in the year 1921 was $342,658.03. The consideration for this payment is that the American Telephone and Telegraph Company supplies at all times to the Pacific Com- [fol. 114] pany and the Home Company certain instrumentalities, services, etc. These instrumentalities and services may be briefly designated as follows:

1. Telephone transmitters, receivers and induction coils.

2. Rights under all patents owned or controlled by the American Company covering use of telephonic devices, apparatus, methods and systems.

3. The right to use all standardized, new and improved apparatus and methods developed through research and experimental work by the American Company.

4. A guarantee of freedom from royalties, damages and expenses on account of patents arising out of recommended use of apparatus, methods and systems.

5. An organization to prosecute continuously the fundamental work of research and investigation to the end that safety, economy and efficiency in the business will be promoted.

6. Advice and assistance in general engineering, plant, traffic, operating, commercial, accounting, patent, legal, administrative and other methods involved in the efficient, economical and successful conduct of the telephone business.

[fol. 115] 7. Advice and assistance in the financing necessary to develop and enlarge the plants of the Pacific and the Home Companies.

8. Assistance, co-operation and support in promoting the health and welfare of the employes, including the plan

for employes' pensions, disability benefits and death benefits with a provision for guaranteeing the integrity of the funds provided by the Pacific and Home companies for this purpose.

Instrument Service (Receivers, Transmitters and Induction Coils.—It is conceded in this case, by all parties, that, should the only service performed by the American Company be the so called instrument service, the annual charges therefor which might properly be allowed as a deduction from revenue would be in excess of 53 per cent of the total amount paid by respondents to the American Company under the four and one half per cent contract. This particular item is referred to in the record and the briefs as "instrument service."

Other Services.—In our opinion, the cost to the Pacific Company and the Home Company of the other items of service, etc., rendered by the American Company to them would greatly exceed the other 47 per cent of the amount paid under the contract. It is our opinion that the value [fol. 116] of the services rendered by the American Company exceeds the amount paid therefor, and we, accordingly, allow the full amount charged therefor as a deduction from revenue. However, it is also our opinion that the method used in computing the compensation to be paid for these services is not correct in principle. As it is now a revision of rates resulting in a change in revenue brings about a corresponding change in the amount in dollars to be paid under the contract. In other words, having found that four and one-half per cent of certain gross revenues under existing rates is just and equitable, it can not logically be said that four and one-half per cent of the revenues derived from increased rates is also fair without some showing of additional facilities furnished or services rendered by the American Company. We believe that a method of computing the payments under the contract which will not be influenced proportionately by changes in operating revenues can be found. Such a method would be more equitable and less objectionable than the present flat percentage method. We are, therefore, adopting a method of determining the amount of compensation which should be paid, which we believe will accomplish that end

and at the same time be fair to the companies and to their patrons. Naturally, as an exchange or a plant increases there will be a greater demand for instrumentalities and service and this demand will grow as the size and import-
[fol. 117] ance of the exchange increases or grows. Therefor, in our opinion, the only fair and logical method of fixing and standardizing this compensation is upon a per station basis. We believe that the present compensation in dollars is reasonable for the service rendered and should be approved. Dividing the contract payment for 1922 by the average number of exchange stations served by respondents a figure of $2.15 per station is derived. Therefore in this case the amount of compensation for services performed under this contract that is approved as a deduction from revenue is computed at the rate of $2.15 per exchange station. The total approved allowance for this compensation is not changed by the increase in rates allowed.

The four and one-half per cent contract has been the subject of investigation by practically every public service commission or similar regulatory body in the United States, and it is of interest to note that the full four and one-half per cent has been allowed by twenty-one commissions, and that the amount has been reduced by only seven commissions. Ten state commissions have not only allowed the full amount under the contract but have approved the percentage system of computing compensation. Eleven states, although they have allowed the full amount, have not approved the percentage method.

[fol. 118] The contract has been the subject of exhaustive investigation by the Public Service Commission of this state as far back as the year 1912 and we have in our files as a result of the first investigation two volumes of some 540 pages of testimony and exhibits relating thereto. At that time two members of the Public Service Commission of this state held an inquiry in New York City, the home office of the American Telephone and Telegraph Company, and inquired into every conceivable angle of the subject.

This matter was before the Public Service Commission of this state in our Cause No. 4747 Public Service Commission, et al v. Pacific Telephone and Telegraph Company and the Postmaster General, and in the decision (1919 annual report, page 168) we find the following:

"At a large expense this Commission several years ago made a thorough investigation of this contract, but at that time entered no order concerning it. We have reached the conclusion that it is a beneficial arrangement conducive to telephone development and service. A number of other state commissions have analyzed and discussed it and in the main have supported it."

And again in that same order, we find the following:

"Between the Bell system and its constituent companies there has for many years existed what is known as the [fol. 119] four and one half per cent (4½%) contract. This contract is recognized and made a part of the agreement between the Bell System and the constituent companies joining and the Postmaster General."

The Supreme Court of the United States, in City of Houston v. Southwestern Bell Telephone Company, and Southwestern Bell Telephone Co. v. City of Houston et al., U. S. Supreme Court Advance Opinions 1921-22, No. 16, July 1, 1922, p. 539, stated:

"The American Telephone and Telegraph Company owns substantially all of the stock of the Company and a large majority of the stock of the Western Electric Company. From the American Telephone and Telegraph Company the Company leases its instruments and secures their maintenance and renewal, and from the Western Electric Company it obtains the greater part of its equipment and supplies used in operating its local exchange. It is contended by the City that no fair disclosure was made of the profits made by the furnishing companies on the instruments and on the material and supplies so furnished, and that, for this unique reason, the Company should not be heard in a court of equity and the case should be dismissed. It is true that the Company did not introduce proof to show what the profits of the two companies were, either upon the business done with it or on their entire business; but it did introduce much evidence tending to show that the charge made and allowed for the services rendered and supplies furnished by them was reasonable and less than the same could be obtained for from other sources. Under [fol. 120] the circumstances disclosed in the evidence, the

fact that the American Telephone and Telegraph Company controlled the Company and the Western Electric Company by stock ownership is not important beyond requiring close scrutiny of their dealings to prevent imposition upon the community served by the Company, but the Court recognized and applied this rule."

Although there are many Commission decisions, whereby the four and one-half per cent contract is discussed in detail, and approved, as above indicated, we think it necessary to quote from only one of these decisions, as bearing upon the reasonableness of the compensation paid for the services rendered.

We quote from a decision of the Commission of the State of Alabama, City of Birmingham v. Southern Bell Telephone Co., 84 Commission Leaflet No. 1 (1918):

"The development of the general staff of the American Telephone and Telegraph Company has so grown, and its functions so broadened, that at the present time it renders available to the respondent company"—(The respondent company was in the position of the Pacific and Home companies here)—"the entire telephone experience of the world, with everything that is of general value in the telephone art and sciences, whether covered by patents or not. It is plain to the Commission that it is absolutely necessary for the respondent company to keep in touch at all times with all improvements in the telephone arts and sciences, and whether it does this through contract with the Ameri- [fol. 121] can Telephone and Telegraph Company, or through its own efforts, the Commission is not concerned.

"The Commission is naturally interested as to whether the respondent company could get this service cheaper in some other way, either by furnishing it itself, or by some other source. It is obvious that much of this service could not be obtained any other way except in a central organization. It would be impossible to render to every one all of the patent inventions which so largely make up the improvements in the arts of telephony. If each telephone company attempted to organize a general staff, it appears to the Commission that each company would absolutely retain its own inventions, and no company could acquire the right to use everything that will aid in the most efficient

and economical service. Moreover, the expense of such organization, it occurs to the Commission, would be prohibitive, unless it were distributed over a large system.

"The fact, if it be a fact, that this arrangement or contract is also a desirable contract from the standpoint of the American Telephone and Telegraph Company does not, to the mind of this Commission, affect the situation whatsoever. This is ordinarily true, of course, of all such contracts. If, for instance, the respondent company rented its instruments from some one else, the person who rented them to the company would expect a profit, and would certainly be entitled to one. Sound business transactions benefit all parties to them."

7. Total Deductions from Revenues.—This is the total of items 2, 3, 4, 5 and 6 and comprises all expenditures reasonably deductible from revenue in computing a rate of return.

[fol. 122] 8. Operating Income.—This is the residue of operating revenue remaining after paying all expenses of operation except interest and dividends. It is obtained by subtracting Item 7 from Item 1.

9. Interest During Construction.—This item comprises the accruals of interest on moneys expended on construction work in progress and is computed on the monthly balances in that account. It is added to Item 8 as an offsetting factor for the inclusion of Construction Work in Progress in the rate base.

10. Adjusted Operating Income.—This item is merely the sum of Items 8 and 9.

11. Rate Base.—This item is the amount in dollars upon which the utility is entitled to earn a reasonable return. It is derived from the rate base figure in Finding 1. The amounts stated herein are average figures for the period and do not represent the rate base as of any specific date.

12. Rate of Return.—This item is the percentage obtained by dividing the Adjusted Operating Income by the Rate Base. It is analogous to an interest rate and represents the percentage earning or interest on the rate base.

[fol. 123]

III

Hotel Rates

Finding:

The rates proposed by the respondent applicable to hotels are in our opinion unjust, unfair and unreasonable for the service rendered, and the same will be disallowed. Just, fair, reasonable and sufficient rates for this service are included in the rate schedule herein set forth.

IV

Toll Message Rates

Finding:

The charges for toll messages now made by the respondent are unjust, unfair, unreasonable, and less than sufficient. The respondent Pacific Company should therefore file a revised toll rate schedule in accordance with the following specifications:

1. The classes of service at present being given to be continued.

2. The distances or base rates on each intrastate route to remain unchanged.

3. In all other respects the revised toll rate schedule, rules and regulations, shall be similar to the present tariff now in effect with the following exceptions:

[fol. 124] a. The initial period for all station to station intrastate messages shall be three minutes, and the charge for each additional minute or fraction thereof shall be one third of the initial rate.

b. The initial period for all person to person, messenger and appointment intrastate messages shall be two minutes and the charge for each additional minute or fraction thereof shall be one half of the initial rate.

c. If the initial rate for station to station messages is not evenly divisible by three, the charge for each additional minute or fraction thereof for this classification shall be calculated to the next lower multiple of five cents.

d. If the initial rate for person to person, messenger or appointment calls is not evenly divisible by two, the charge for each additional minute or fraction thereof for these classifications shall be calculated to the next lower multiple of five cents.

Discussion:

As stated in our order suspending the company's proposed rates we have reached certain conclusions which we consider more or less fundamental in connection with the rate structure of telephone utilities.

a. From facts thus far developed the Department is inclined to the view that property used and useful devoted [fol. 125] to the service of the public should be considered as a whole and the rate schedule so designed as to produce a reasonable return on a reasonable value of the property as a whole, provided that no form of tariff or system of grouping, or segregation, should be adopted that will unduly favor any community or class of communities, to the disadvantage of others.

b. That the toll or long distance rate schedules should be in keeping with the competitive conditions to be met and with due regard to the value of the service rendered, to the end that the local exchange rate schedules, which intimately touch the lives of all of the people of this state and which are a domestic necessity, should be as low as possible.

The changes above directed in the toll schedule will accomplish the result contemplated by the Department in its suspension order.

V

Exchange Rates

Finding:

The existing exchange rates and charges of the respondents are unjust, unfair, unreasonable and less than sufficient. The exchange rates proposed by the respondents in their respective tariffs W. D. P. W. No. 3, are unjust, un- [fol. 126] fair, unreasonable and more than sufficient. The

exchange rates as set out on succeeding pages herein are just, fair, reasonable and sufficient.

That the respondents should file with this Department tariffs containing the schedule of rates herein found to be just, fair, reasonable and sufficient, but containing in all other respects the same rates, rules and regulations as are contained in their respective exchange rate schedules, W. D. P. W. No. 3, now on file with the Department and under suspension.

That had said rates been in effect during the entire calendar year of 1923, the Pacific system in the State of Washington would have realized a rate of return of 7.34 per cent, as computed on the estimated rate base for that year of $34,789,635.00, which rate of return is just, fair, reasonable and not more than sufficient.

Rates—Seattle Exchange

Business—Unlimited Service

	Rate per month	
	Wall set	Desk set
Individual Line	$10.50	$10.75
Extension (with or without bell)	1.00	1.25
Suburban Service—Ten party Line	3.50	3.75

Business—Measured Service

	Rate per month		Free exchange messages per month	Each additional message exchange
	Wall set	Desk set		
Individual Line	$8.50	$8.75	120	$ .05
Extension (with or without bell)	.75	1.00		

[fol. 127] Semi-Public—Coin Box Service

	Rate per day		Each exchange message
	Wall set	Desk set	
Individual Line	$ .30	$*	$ .05

* 25¢ per month additional

	Wall set	Desk set
Extension (with or without bell) per month	$1.00	$1.25

Residence—Unlimited Service

	Rate per month	
	Wall set	Desk set
Individual Line	$4.25	$4.50
Two party Line	3.50	3.75
Four party Line	2.75	3.00
Extension (with or without bell)	.75	1.00
Suburban—Ten party Service	3.00	3.25

Rates—Tacoma Exchange

Business—Unlimited Service

	Rate per month	
	Wall set	Desk set
Individual Line	$8.00	$8.25
Extension (with or without bell)	1.00	1.25
Suburban Service—Ten party Line	3.50	3.75

Business—Measured Service

	Rate per month		Free exchange messages per month	Each additional exchange message
	Wall set	Desk set		
Individual Line	$5.50	$5.75	110	$.05
Extension (with or without bell)	.75	1.00	....	....

Semi-Public—Coin Box Service

	Rate per day		Each exchange message
	Wall set	Desk set	
Individual Line	$.20	$*	$.05

	Wall set	Desk set
Extension (with or without bell) per month	$1.00	$1.25

Residence—Unlimited Service

	Rate per month	
	Wall set	Desk set
Individual Line	$3.50	$3.75
Two party Line	2.75	3.00
Four party Line	2.25	2.50
Extension (with or without bell)	.75	1.00
Suburban Ten party Service	3.00	3.25

[fol. 128] Rates—Spokane Exchange

Business—Unlimited Service

	Rate per month	
	Wall set	Desk set
Individual Line	$8.50	$8.75
Extension (with or without bell)	1.00	1.25
Suburban Service—Ten party Line	3.50	3.75

* 25¢ per month additional

Business—Measured Service

	Rate per month		Free exchange messages per month	Each additional exchange message
	Wall set	Desk set		
Individual Line	$5 50	$5 75	110	$ 05
Extension (with or without bell)	75	1 00		

Semi-Public—Coin Box Service

	Rate per day		Each exchange message
	Wall set	Desk set	
Individual Line	$ 20	$*	$ 05

* 25c per month additional

	Wall set	Desk set
Extension (with or without bell) per month	$1 00	$1 25

Residence—Unlimited Service

	Rate per month	
	Wall set	Desk set
Individual Line	$3 75	$4 00
Two-party Line	3 00	3 25
Four-party Line	2 50	2 75
Extension (with or without bell)	75	1 00
Suburban—Ten party service	3 00	3 25

Hotel Private Branch Exchange Service Rates, Seattle, Tacoma, and Spokane Exchanges

Unlimited Service

Switchboard or Order Board, with Battery Power Ringing Circuit, Position Dial, Switchboard Telephone, Each Position

	Rate per month
Cordless Type	$3 00
Non-Multiple Cord Type:	
10 lines or less in use	5 00
11- 30 lines in use	6 00
31- 60 lines in use	7 00
61-100 lines in use	8 00
101-150 lines in use	9 00
151-200 lines in use	10 00
201-260 lines in use	11 00
261-320 lines in use	13 00
[fol. 129] Multiple Cord Type:	
Each position with not to exceed one multiple jack per line	15 00
Each additional strip of ten multiple jacks or portion thereof	30

Stations on Premises in Which Switchboard or Order Board is Located and Connected with that Board

	Seattle	Tacoma	Spokane
Each station not in guest room, without dial—			
Wall Set	$1 25	$0 95	$1 00
Desk Set	1 50	1 20	1 25
Each station not in guest room, with dial—			
Wall Set	1 50	1 15	1 20
Desk Set	1 75	1 40	1 45
Each station in guest room, without dial—			
Wall Set	75	55	60
Desk Set	1 00	80	85
Each station in guest room, with dial—			
Wall Set	1 00	75	80
Desk Set	1 25	1 00	1 05

Stations outside premises in which switchboard or order board is located—See Mileage Rates—Section 3.

Trunk lines to central office from switchboards or order boards. Each bothway trunk line—Individual Line business rate plus $3.00. Each incoming trunk line—Individual Line business rate.

Tie lines from switchboard or order board or between separate switchboards—See Mileage Rates, Section 3.

Applications are not accepted for less than two (2) trunk lines and four (4) stations, excluding switchboard telephones. If the switchboard is to be installed outside the primary rate area—See Mileage Rates, Section 3.

[fol. 130] Statement of Operating Income and Rate of Return Estimate for the year 1923

	Present rates	Company proposed rates	Department allowed rates
1. Operating Revenues	$9,300,441 00	$11,474,615 00	$10,751,350 00
Deduction from Revenues:			
2. Operating Expenses (excl. Depreciation)	5,603,889 00	5,603,889 00	5,603,889 00
3. Taxes Assignable to Operations	581,000 00	658,057 00	637,413 00
4. Uncollectible Revenues	35,618 00	48,367 00	44,445 00
5. Depreciation (on Depreciable Property)	1,674,024 00	1,674,024 00	1,674,024 00
6. Licensee Revenue—Dr	386,170 00	386,170 00	386,170 00
7. Total Deductions from Revenues	$8,280,701 00	$8,370,507 00	$8,345,941 00
8. Operating Income	$1,019,740 00	$3,104,108 00	$2,405,409 00
9. Interest during Construction	148,122 00	148,122 00	148,122 00
10. Adjusted Operating Income	$1,167,862 00	$3,252,230 00	$2,553,531 00
11. Rate Base (incl. Const. Work in Progress)	$34,789,635 00	$34,789,635 00	$34,789,635 00
12. Rate of Return	3 36%	9 35%	7 34%

[fol. 131] Farmer Line Rates

Finding No. VI:

We find that irregularities and discrimination exist in the rates now being charged by respondent for farmer line service. In order to equalize and standardize these rates the respondent should file a supplement to its tariff effective on and after April 1, 1923, carrying the following schedule of charges:

Where the number of exchange station is—	The annual farmer line rate shall be
Over 20,000	$15 00
10,000 to 20,000	11 00
5,000 to 10,000	8 00
3,000 to 5,000	6 00
2,000 to 3,000	5 00
1,000 to 2,000	4 00
500 to 1,000	3 50
Under 500	3 00

Reparation

Finding No. VII:

The contention made by the City of Seattle relative to the validity of the present rates of the company and their prayer for a general reparation order is not supported by the facts or the law, and that portion of the complaint should therefore be dismissed.

[fol. 132] Discussion:

The existing rates of the Pacific Telephone and Telegraph Company were first established during the period of Federal control, and inasmuch as there existed a doubt as to the validity and legality of rates established during that period being legally continued without some affirmative action on the part of the Commission, the Pacific Telephone and Telegraph Company at the conclusion of Federal control refiled with the Commission the same schedule of rates and the Public Service Commission entered an affirmative order permitting the same to become effective on less than statutory notice.

We find nothing in the record which would lead us to any conclusion except that the rates now in effect are and have been since the conclusion of Federal control the only legal and valid rates applicable during that period.

Petitions to Reopen Case

Some two weeks subsequent to the conclusion of all of the hearings in this case, the Seattle Chamber of Commerce, the Port of Seattle and the County Commissioners of King County, Washington, filed with the Department petitions requesting the reopening of this case. The time for the suspension of the proposed increase in rates in this case expires on April 1, 1923.

[fol. 133] In view of the foregoing statements relative to procedure notice, etc., the wide newspaper publicity given the matter periodically since the latter part of the year 1921, and in the absence of a showing warranting the same (the matters in the petition pertinent to the issues having been fully covered by the investigation and reports) petitions for the reopening of this case will be denied.

Dismissal of Cause No. 4902

Cause No. 4902 entitled The Public Service Commission of Washington v. The Pacific Telephone and Telegraph Company is an old proceeding relating to facilities and service of respondent in the City of Seattle. There being no reason for continuing the same upon our docket, the matters and things therein alleged being no longer an issue, the same is hereby dismissed.

Order

It is hereby ordered:

1. That the respondents, Pacific Telephone and Telegraph Company and Home Telephone and Telegraph Company of Spokane, file with this Department within fifteen (15) days from the date of service of this order, tariffs or supplements to their respective tariffs in conformity with the findings of fact and directions herein contained; and [fol. 134] that all rates, rules and regulations as amended

or supplemented as herein found and ordered be, and they are hereby made effective as of April 1st, 1923.

2. That Cause No. 4902 entitled "The Public Service Commission of Washington v. The Pacific Telephone and Telegraph Company" be, and the same is hereby dismissed.

Witness the Department of Public Works of Washington this 31st day of March, 1923.

Department of Public Works of Washington, by ——— ———, Director. Hance H. Cleland, Supervisor of Public Utilities. ———, Supervisor of Transportation.

Attest: ——— ———, Secretary.

[fol. 135] EXHIBIT "F"

The Home Telephone and Telegraph Company of Spokane

Exchange Rates, Spokane, Washington, Set Out in Dissenting Opinion of Hance H. Cleland, Supervisor of Public Utilities, State of Washington in Case Numbers 902 and 5344

Spokane Exchange

Business—Unlimited Service

	Rate per month	
	Wall set	Desk set
Individual Line	$3.50	$3.75
Extension (with or without bell)	1.00	1.25
Suburban Service—Two-party Line	3.50	3.75

Business—Measured Service

	Rate per month		Five each message per month	Each additional exchange message
	Wall set	Desk set		
Individual Line	$3.50	$3.75	150	$ .05
Extension (with or without bell)	.75	1.00		

Semi-Public Coin Box Service

	Rate per day		Each Exchange message
	Wall set	Desk set	
Individual Line	$ .20	*	$ .05

	Wall set	Desk set
Extension (with or without bell) per month	$1.00	$1.25

*25¢ per month additional.

[fol. 136] Residence—Unlimited Service

	Rate per month	
	Wall set	Desk set
Individual Line	$3.75	$4.00
Two party Line	3.00	3.25
Four party Line	2.50	2.75
Extension (with or without bell)	.75	1.00
Suburban—Ten party service	3.00	3.25

Hotel Private Branch Exchange Service Rates Spokane Exchange—Unlimited Service

Switchboard or Order Board with Battery Power Ringing Circuit, Position Dial, Switchboard Telephone, Each Position

	Rate per month
Cordless Type	$3 00

Non Multiple Cord Type:

10 lines or less in use	5 00
11- 30 lines in use	6 00
31- 60 lines in use	7 00
61-100 lines in use	8 00
101-150 lines in use	9 00
151-200 lines in use	10 00
201-260 lines in use	11 00
261-320 lines in use	13 00

Multiple Cord Type:

Each position with not to exceed one multiple jack per line	15 00
Each additional strip of ten multiple jacks or portion thereof	30

Stations on premises in which switchboard or order board is located and connected with that board.

	Spokane
Each station not in guest room, without dial—	
Wall Set	$1 00
Desk Set	1 25
[fol. 137] Each station not in guest room, with dial—	
Wall Set	1 20
Desk Set	1 45

	Spokane
Each station in guest room, without dial—	
Wall Set	60
Desk Set	85
Each station in guest room, with dial—	
Wall Set	80
Desk Set	1 05

Stations outside premises in which switchboard or order board is located—See Mileage Rates, Section 3.

Trunk Lines to central office from switchboard or order boards—

Each bothway trunk line—Individual Line business rate plus $3 00

Each incoming trunk line—Individual Line business rate.

Tie lines from switchboard or order board or between separate switchboards—See Mileage Rates, Section 3.

Applications are not accepted for less than two (2) trunk lines and four (4) stations, excluding switchboard telephones. If the switchboard is to be installed outside the primary rate area—See Mileage Rates, Section 3.

[File endorsement omitted.]

[fol. 138] In United States District Court

[Title omitted]

Answer to Amended and Supplemental Complaint—Filed May 28, 1925

This, the joint answer of John C. Denney, as Director of Public Works of Washington, O. C. Calderhead, as Supervisor of Public Utilities of Washington, and Frank R. Spinning, as Supervisor of Transportation of Washington, the persons constituting the Department of Public Works of the State of Washington, and John H. Dunbar, Attorney General of the State of Washington, to the amended and supplemental complaint herein, shows:

I

They admit the allegations of paragraphs one, two and three thereof.

II

These defendants admit the allegations of paragraph four of the amended and supplemental bill of complaint, except that these defendants deny that the order of the Department of Public Works therein referred to is confiscatory of plaintiff's property, or that they seek, or that any of them seeks, to deprive plaintiff of its property without due process of law, or to deny to plaintiff the equal protection of the laws in violation of the Fourteenth Amendment to the Constitution of the United States.

[fol. 139] III

These defendants admit the allegations of paragraphs five, six, seven and eight of the amended and supplemental bill of complaint.

IV

As to the allegations of paragraph nine of the amended and supplemental bill of complaint, these defendants on information and belief, deny that the cost to plaintiff of its property in the Spokane exchange (land being included at present value) and used or useful in furnishing intrastate and interstate telephone service to the public therein, and exclusively devoted to the rendition of said service was, as of June 30, 1922, the sum of $4,056,215 or in any sum in excess of the sum of $3,500,000. They admit that the sum of $4,056,215 is substantially the rate base fixed for the plaintiff as of June 30, 1922, by the Department of Public Works in its said order of March 31, 1923.

V

As to the allegations of paragraph ten of the amended and supplemental bill of complaint, these defendants, on information and belief, deny that the cost to plaintiff of its property in the Spokane Exchange (land being included at present value) and used or useful in furnishing intra-

state telephone service to the public therein and exclusively devoted to the rendition of that service was, as of December 31, 1922, the sum of $4,073,399, or any sum in excess of $3,000,000. They deny that the cost of reproduction of said property as it existed on December 31, 1922, was the sum of $7,793,411, or any sum in excess of $4,000,000. They deny that the cost of reproduction of said property less depreciation was, as of December 31, 1922, the sum of $7,145,314, or any sum in excess of $3,500,000. They deny that the fair and reasonable value of said property, was, as of December 31, 1922, the sum of $5,497,049, or any sum in excess of $3,500,000.

[fol. 140] They admit that none of the statements contained in paragraph 10 of the amended and supplemental bill of complaint as to the cost to plaintiff of said property includes nothing on account of the item of franchise or the item known as "going concern" value, and they deny that there has been any cost to or value to plaintiff on account of said items or either of them.

They have no knowledge or information sufficient to form a belief as to whether the item of "going concern" value was considered by plaintiff in calculating the cost of reproduction or estimating the fair and reasonable value of said property.

VI

As to the allegations of paragraph 11 of said amended and supplemental bill of complaint, they deny that plaintiff is entitled to earn the sum of at least eight per cent per annum on the fair and reasonable value of its property used or useful in the rendition of service to the public covered by the rates in question, and they deny that plaintiff is entitled to earn on said value any rate in excess of six per cent per annum.

VII

As to the allegations in paragraph 12 of said amended and supplemental bill of complaint, these defendants, on information and belief, deny that plaintiff's telephone business in the Spokane exchange has been conducted efficiently and economically during any of the times therein referred

to. These defendants allege that plaintiff's net earnings referred to in said paragraph are matters of conclusion from facts, rather than matters of fact capable of exact statement, and said defendants, on information and belief, deny that plaintiff's net earnings on the cost and fair value of its property in the Spokane exchange are the sums respectively set forth in said paragraph, but, on the contrary, they allege, on information and belief, that said net returns, [fol. 141] properly computed, are much larger than as stated in plaintiff's amended and supplemental bill of complaint, and will and do amount to the sum of $500,000 per annum. These defendants, on information and belief, deny that the fair and reasonable value of plaintiff's property, used and useful in public service in the Spokane exchange, is substantially or any in excess of its cost.

VIII

As to the allegations of paragraph 13 of said amended and supplemental bill of complaint, these defendants, on information and belief, deny that during the years 1919, 1920, 1921 and 1922, plaintiff's rates were not compensatory, or were less than just and reasonable rates, but, on the contrary, said defendants, on information and belief, allege that said rates for said period were compensatory, just and reasonable. These defendants, on information and belief, deny that the amounts by which the net revenue derived by the plaintiff from its telephone and telegraph business in the Spokane exchange were less than eight per cent. of the cost of the property or useful in each case and exclusively devoted to the rendition of service within said state and for said exchange in the amounts set forth in said paragraph 13 of the amended and supplemental bill of complaint, but, on the contrary, they, on information and belief, allege that the net returns of plaintiff, properly computed, on its said properties do not differ in any respect from a fair and reasonable return.

IX

They admit the allegations of paragraphs 14 to 17, inclusive, of said amended and supplemental bill of complaint.

X

As to the allegations of paragraph 18 of said amended and supplemental bill of complaint, they deny that the cost to plaintiff of its property in the Spokane exchange (land being included at present value) and used or useful in furnishing its intrastate telephone service to the public therein and exclusively devoted to the rendition of that service was, [fol. 142] as of the thirty first day of December, 1923, the sum of $4,204,898 or any sum in excess of the sum of $3,000,000; and they deny that the value of said property, as of July 31, 1924, was the sum of $4,517,382, or any sum in excess of $3,000,000. They deny that the fair and reasonable value of said property was, as of the thirty first day of December, 1923, the sum of $5,628,549, or any sum in excess of $3,500,000. They deny that the fair and reasonable value of said property, as of July 31, 1924, was the sum of $5,941,033, or any sum in excess of $3,500,000.

They admit that plaintiff's statement as to the cost of said property, at the dates in said paragraph mentioned, includes nothing on account of the item of franchise and the item of "going concern" value, and they deny that there was any cost to plaintiff on account of either of said items, they having no knowledge or information sufficient to form a belief as to whether plaintiff, in alleging the fair and reasonable value of its property, included anything for the item known as "going concern" value, and allege affirmatively that no money was expended by plaintiff therefor.

XI

As to the allegations of paragraph 19 thereof, they deny that from January 1, 1923 to August 1, 1924, plaintiff practiced reasonable economy consistent with adequate and efficient service to the public. They deny that its net earnings derived from intrastate telephone business, as stated in said paragraph, was the amount there stated, and allege affirmatively that upon a proper valuation of its property and a proper computation of its earnings, it earned during said period, on both its cost and fair value, at least eight per cent. per annum.

They deny that the net revenues derived by plaintiff from its intrastate telephone business in the Spokane exchange, during the period from January 1, 1923 to August 1, 1924, were less than eight per cent. on its cost or fair value, and they allege affirmatively that during the said [fol. 143] period of time they earned at least eight per cent. on its cost and upon its fair value under a proper computation of its earnings.

XII

As to the allegations of paragraph 20 of said amended and supplemental bill of complaint, they deny that the cost to plaintiff of its property in the Spokane (land being included at its present value) and used or useful in furnishing its intrastate telephone service to the public, was, as of the thirty first day of December, 1924, the sum of $4,624,812, or any sum in excess of $3,000,000. They have no knowledge or information sufficient to form a belief as to whether since December 31, 1924, any sum has been expended on account of additions to betterments made to said property. They deny that the fair and reasonable value of said property of plaintiff was, as of the thirty first day of December, 1924, the sum of $6,048,462, or any sum in excess of the sum of $3,500,000.

They admit that the statement in said paragraph contained as to the cost to plaintiff of said property includes nothing on account of the item of franchise or "going concern" value, and they deny that plaintiff incurred any cost on account of either the said items. They have no knowledge or information sufficient to form a belief as to whether in determining the fair and reasonable value of said property in said paragraph, plaintiff has included anything for "going concern" value, and they deny that any amounts have been expended by plaintiff on account of said items.

XIII

As to paragraph 21 thereof, they deny that plaintiff, from July 31, 1924, to December 31, 1924, practiced all reasonable economies consistent with adequate and efficient service to the public. They deny that during the said period

of time plaintiff's net earnings upon said property on the cost thereof were 6.44% per annum and on fair value 4.92% per annum.

And they allege affirmatively that during said period the plaintiff's net earnings upon the cost and the fair value [fol. 144] of said property were in excess of eight per cent per annum. They deny that the net revenues from plaintiff's intrastate business during said period were less than eight per cent. on the cost and fair value of the property during said period in the sums therein set forth or in any whatsoever.

XIV

As to the allegations of paragraph 22 thereof, they deny that the rates and charges collected by plaintiff from August 1, 1924, to December 31, 1924, are less than the just and reasonable rates and charges to which plaintiff is lawfully entitled, and allege affirmatively that said rates and charges are much in excess of the rates and charges to which plaintiff is lawfully entitled.

XV

As to the allegations of paragraph 23 of said amended and supplemental bill of complaint, defendants deny that unless they are restrained and enjoined herein, the plaintiff, or anyone in its behalf, by any attempt of these defendants to compel a compliance with that certain order of March 31, 1923, or to enforce penalties or otherwise, will be forced to submit to confiscation of plaintiff's property without due process of law and in violation of plaintiff's rights under the Constitution of the United States, and will be subject to great and irreparable loss or damage, or any loss or damage, and they deny that plaintiff has no speedy or adequate remedy at law.

And for a further, separate and affirmative answer and defense to said amended and Supplemental Bill of Complaint, these defendants allege and say:

1. Heretofore, to wit, on the eleventh day of August, 1905, pursuant to the provisions of law and the Charter of the City of Spokane, Washington, an election was duly held in

said city wherein and whereby a franchise was granted to the plaintiff herein for the operation of a telephone sys- [fol. 145] tem within the limits of the City of Spokane; that said franchise so granted is evidenced by Ordinance No. A2118 of the City of Spokane, Washington, entitled:

"An ordinance granting to the Home Telephone & Telegraph Company of Spokane the right, privilege and franchise to erect poles and string wires and cables thereon, to construct underground conduits and manholes, and to lay wires and cables in underground conduits and through man holes, and to stretch wires and cables along, over, upon and across the streets, alleys, avenues and public places in the City of Spokane for the transmission of sounds, signals, conversation and intelligence through and over said wires and cables, by means of electricity, and to construct, establish, equip and install a telephone and telegraph system, and to conduct a general telephone and telegraph business within the said City of Spokane, and fixing the compensation to be paid therefor."

And that thereafter said ordinance was amended by Ordinance No. A4079 of said City of Spokane, passed by the City Council April 13, 1909, and approved by the Mayor thereof April 4, 1909, and entitled:

"An ordinance amending section 13 of Ordinance No. A2118, entitled 'An ordinance No. A2118, granting to The Home Telephone and Telegraph Company of Spokane the right, privilege and franchise to erect poles and string wires and cables thereon, to construct underground conduits and manholes, and to lay wires and cables in underground conduits and through manholes, and to stretch wires and cables along, over, upon and across the streets, alleys, avenues and public places in the City of Spokane, for the transmission of sounds, signals, conversation and intelligence through and over said wires and cables by means of electricity, and to construct, establish, equip and install a telephone and telegraph system, and to conduct a general telephone and telegraph business within the said City of Spokane, and fixing the compensation to be paid therefor.'"

That a true and correct copy of said Ordinance No. A2118 is filed herewith, attached hereto, marked Exhibit "A" and hereby specially referred to and made a part hereof.

That a true and correct copy of said Ordinance No. A4079 is filed herewith, attached hereto, marked Exhibit "B" and hereby specially referred to and made a part hereof.

2. That the terms and conditions of said ordinances were duly accepted by the plaintiff herein, and that ever since said acceptance the plaintiff herein has been, and now is, the owner of said franchise and has been, and now is, operating thereunder, save as hereinafter set forth.

3. That it has been adjudicated by the Supreme Court of the State of Washington in that certain judgment and [fol. 146] opinion rendered in the case of the State of Washington on the relation of Harvig Ellertsen, respondent, versus The Home Telephone and Telegraph Company of Spokane, appellant, 102 Wash. 196, that said franchise constitutes a valid contract between the plaintiff herein on the one hand and the City of Spokane and each of its citizens on the other hand, save as it might be modified by the Department of Public Works of the State of Washington or by its predecessor in office, the Public Service Commission of the State of Washington.

4. That no order in relation to the said contract has ever been made by the Public Service Commission of Washington or the Department of Public Works of the State of Washington, save that on the twentieth day of March, 1919, the Public Service Commission of Washington attempted to make an order by consent of the plaintiff herein and the City of Spokane, Washington, which order permitted the putting into effect of the rates set forth in Exhibit "A" attached to the amended and supplemental bill of complaint herein, and in which order the following language was used:

"It is further ordered that all contracts in conflict with the rates provided for in Postmaster General's Tariff W. P. S. C. No. 2, as modified, of the Home Telephone and Telegraph Company of Spokane be terminated.

"It is further ordered that the effective date of said Tariff as modified shall be April 1, 1919."

5. That the said attempted order was, and is, a nullity in that the property of the Home Telephone and Telegraph Company was then in the exclusive possession and control of the President of the United States by virtue of the laws of the United States, and the Public Service Commission of Washington was without jurisdiction to make any order relating to the rates of the plaintiff herein.

Wherefore, these defendants having fully answered all the matters in the amended and supplemental bill of com- [fol. 147] plaint herein material to be answered according to their best knowledge and belief, humbly pray this Honorable Court that the said defendants be hence dismissed with their reasonable costs and charges, and said defendants humbly pray for such other relief in the premises as to this Honorable Court may seem meet and in accordance with equity.

Department of Public Works of Washington, by John C. Denney, Director of Public Works. O. O. Calderhead, Supervisor of Public Utilities. Frank R. Spinning, Supervisor of Transportation. John H. Dunbar, Attorney General. Attest: C. E. Van Etten, Secretary. (Seal.) John H. Dunbar, Attorney General; H. C. Brodie, Assistant Attorney General, Solicitors for Defendants. J. M. Geraghty, Alex M. Winston, of Counsel.

[fol. 148] EXHIBIT "A" TO ANSWER

Ordinance No. A2118

An Ordinance granting to the Home Telephone & Telegraph Company of Spokane, the right, privilege and franchise to erect poles and string wires and cables thereon, to construct underground conduits and manholes, and to lay wires and cables in underground conduits and through manholes, and to stretch wires and cables along, over, upon and across the streets, alleys, avenues and public places in the City of Spokane for the transmission of sounds, signals, conversation and intelligence through and over said wires and cables, by means of electricity, and to construct, establish, equip and install a telephone and telegraph system, and to conduct a general telephone and telegraph business within the said City of Spokane, and fixing the compensation to be paid therefor.

The City of Spokane does ordain, as follows:

Section 1. That the Home Telephone & Telegraph Company of Spokane, be and it is hereby granted the right, privileges and franchise to erect poles, with the necessary supports, crossarms and fixtures, and string wires and cables thereon, and to construct underground conduits, and to lay, place and stretch wires and cables therein, along, over, upon, under and across the streets, alleys, avenues and public places of the City of Spokane for the transmission of sounds, signals, conversation and intelligence through and over said wires and cables by means of electricity, and to construct, establish, equip and install, maintain and operate a telephone and telegraph system and to conduct a general telephone and telegraph business within the said City of Spokane.

Section 2. Said grantee shall construct the underground system, under the supervision and direction of the board of public works of the said City of Spokane or such other board or official of the said City of Spokane as may be lawfully designated.

The grantee shall place, lay, maintain and operate its [fol. 149] cables in underground conduits and pipes within

the district bounded and described as follows, to-wit: Commencing at a point where the Northerly line of First Avenue intersects the easterly line of Monroe Street, in said City of Spokane, thence along the easterly line of Monroe Street to the point where the said easterly line of Monroe Street intersects the southerly line of Main Avenue, thence along the southerly line of Main Avenue to a point where the southerly line of Main Avenue intersects the easterly line of Lincoln Street, thence along the easterly line of Lincoln street to the point where the easterly line of Lincoln Street intersects the southerly line of Front Avenue, thence along the Southerly line of Front Avenue to a point where the southerly line of Front Avenue intersects the westerly line of Bernard Street, thence along the westerly line of Bernard Street to the point where the westerly line of Bernard Street intersects the Northerly line of First Avenue, thence along the northerly line of First Avenue to the point where the said northerly line of First Avenue intersects the easterly line of Monroe Street.

All necessary connections to subscribers' stations and to other points may be made from such cables sith such means, apparatus, poles, wires and appliances as may be requisite. Said grantee shall, if required by the council, file with the Board of Public Works of said city, plans of all conduits, manholes, distributing poles and all other constructions proposed within the limits of the streets, alleys, highways and public places of the said city, in such form and detail as may be required, and approved in writing. During the entire work of construction authorized by this franchise an inspector may be appointed by the Board of Public Works to see that all the terms and conditions of this franchise are strictly conformed to. All poles erected hereafter by virtue of this franchise and grant shall conform in length and the wires thereon shall conform in height to the reasonable rules and regulations adopted by said Board of Public [fol. 150] Works. Provided, that nothing in this section contained shall be construed as prohibiting the City of Spokane or the Council thereof from, at any time hereafter, exercising its police power to require the main line wires of the grantee to be placed in conduits in any other section of said City, provided that such police power shall not be exercised except by ordinance, applicable alike to all telephone, telegraph and electric light wires and poles, and pro-

vided further, that in the residence portion of said city all poles shall, so far as practicable, be set in alleys, where such alleys exist.

Section 3. That traps or manholes may be constructed along the line of said conduit for the purpose of affording access thereto, provided that said traps or manholes be located or constructed in conformity with the instructions and to the satisfaction of the Board of Public Works of said City; said traps or manholes shall be so capped or covered as to be flush with the surface of the street and not to interfere in any way with the use of said streets for travel or traffic.

Section 4. The said grantee may, under the direction of the Board of Public Works, or such other board or official of the City of Spokane as may be lawfully designated, make all necessary excavations in any of the said streets, alleys or public places for the purpose of erecting and maintaining poles and other supports for its wires or conductors and for repairing the same, and for the purpose of laying, repairing and maintaining said underground pipes and conduits and said manholes, and for placing, repairing, maintaining and operating said wires and conductors therein. All poles that are erected and maintained pursuant to the terms of this ordinance shall be erected at the edge of the sidewalks unless otherwise directed by the Board of Public Works or such other board or official as the Council or law may designate, in a good and substantial manner. When any excavating shall have been made pursuant to the authority hereby granted, the grantee shall restore the portion of the street, alley or public highway excavated to the same good order and condition to which it was prior to said work, and all said work shall be done in compliance with [fol. 151] the reasonable and necessary rules, regulations ordinances or orders which may during the continuance of this franchise be adopted from time to time by the said Council, or provided by law, and said work of repairing said streets, alleys and public highways shall be done to the satisfaction of the said common council, or such official or officials as the law may designate.

Section 5. Nothing in this ordinance shall be construed as in any wise to prevent the proper authorities of the *of the*

said City from sewering, grading, paving, planking, repairing, altering or doing any work that may be desirable on any of the streets, alleys or public highways of said City, but all such work shall be done, if possible, in such a manner as not to obstruct, injure or prevent the free use and operation of the said telephone and telegraph system of said grantee.

Section 6. The grantee, whenever or wherever electric currents are used or employed in or about the use of the franchise by this ordinance granted, or the ground connected therewith, shall provide and put in use such means and appliances as will control and effectually contain such currents in their proper channels on its own wires, so as to prevent injury to the property, pipes and other structures belonging to the City of Spokane or any other person, firm or corporation within said City, and shall repair and renew said means and appliances and from time to time change and improve the same as may be necessary to accomplish said purposes, all at its own charge or expense, and at its risk, selecting and adopting such means and appliances as shall prevent injury to the property, pipes or other structures belonging to the City of Spokane, or any person, firm or corporation.

Section 7. Whenever it shall be necessary in grading any street or alley of said city or in building any sidewalk or making any other improvements thereon, to remove any pole or poles belonding to said grantee, on which any line or lines, wire or wires belonging to grantee shall be [fol. 152] stretched or fastened, the said grantee shall, upon receipt of twenty four hours' notice from the Board of Public Works or such other board or official as the Council or law may designate, remove such pole or poles, and if said grantee, upon such notice, shall neglect or refuse to remove such pole or poles, then such pole or poles shall be removed by the Board of Public Works or such other board or official as the Council or law may designate, at the expense of said grantee.

Section 8. Whenever any person or company shall have obtained permission of the properly constituted authorities of the City of Spokane to remove any building through

any street or streets, the grantee, if it has a line on said streets, on due notice from such person or company, shall raise, remove or adjust its lines so as to allow an unobstructed passage of such building; and if said grantee shall, after said notice, neglect to do so, the properly constituted authority of the City of Spokane shall, at the expense of said grantee, remove said lines as far as they are an obstruction to the passage of said building.

Section 9. For the purpose of effectually securing efficient service and for the purpose of the continued maintenance of the property, plant, system and exchange constructed and operated under this franchise, the grantee shall keep and maintain its poles, conduits, plant, system and exchange in good order and repair, and shall render efficient service throughout the entire term of this grant. If the grantee shall fail at any time to keep in good repair the poles, conduits, wires, plant, system and exchange constructed, operated and maintained under this franchise, or shall fail during the period of this franchise to render efficient service, the Council of said city, may declare this grant and all the rights and privileges herein conferred forfeited, and, upon adjudication of forfeiture by a court of competent jurisdiction, this franchise and all the rights and privileges conferred thereby shall become null and void, but no decree of forfeiture hereof shall be made if [fol. 153] before the rendition of such decree adjudicating such forfeiture the said grantee shall place said plant, system, exchange and property in good order and repair and shall render efficient service thereby and thereafter.

Section 10. That said grantee shall not, without the consent of the City, evidenced by ordinance, sell or transfer the conduits, poles, wires or appliances of any kind or description, or sell, lease, assign or transfer any of the rights or privileges herein authorized or granted to any person, company, trust or corporation now or hereafter engaged in the telephone and telegraph business, and shall not at any time enter into any combination directly or indirectly, with any person or persons, or any corporation concerning the rate to be charged for telephone or telegraph service, nor with any officer or officers, employes or manager of any telephone or telegraph system constructed or being operated in said city.

Section 11. That all telephone lines constructed or operated under said franchise shall have complete copper metallic circuits, and that the conduit system constructed and laid down under this franchise shall be of such size and capacity as to accommodate wires, cables or conductors sufficient to provide for ten thousand (10,000) telephones.

That the rent or charge for an unlimited, independent metallic circuit telephone service in the system established or maintained under this franchise, so long as such system does not connect an exchange with more than four thousand (4,000) telephones, shall not exceed four and twenty-five one hundredths dollars ($4.25) per month; and said charge, so long as such system does not connect an exchange with more than ten thousand telephones, shall not exceed six and twenty-five one hundredths dollars ($6.25) per month; and in no event shall said rent or charge exceed eight and twenty-five one hundredths dollars ($8.25) per month for a telephone installed in any business office or premises for business purposes; and shall not exceed two and twenty-five one hundredths dollars ($2.25) per month [fol. 154] for a telephone installed in a private residence; provided that a discount of twenty-five cents per month shall be made for cash payment on or before the tenth day of the month in which the service is rendered.

Section 12. The said grantee, in consideration of the franchise rights and privileges granted by this ordinance, and as compensation therefor, shall, within thirty days from the commencement of the operation of the said telephone exchange, furnish to the City of Spokane, twenty-five (25) telephones and connect the same with the telephone system of said grantee, and thereafter maintain and keep the same in good repair and working order during the term of said franchise, without expense or charge to said City of Spokane, and shall allow the City of Spokane the free and exclusive use of the upper cross arm on each of the poles erected or maintained under this franchise during the whole term thereof, and as further compensation, said grantee shall pay to the City of Spokane the sum of ninety thousand dollars ($90,000.) as follows, to-wit:

Three thousand dollars ($3,000) on the 1st day of January, 1911, and three thousand dollars ($3,000) on the 1st

day ow January of each and every year thereafter during the life of this franchise, and said franchise may be forfeited by a failure to make the payments herein provided for.

Section 13. The work of constructing said telephone plant, system and exchange to be constructed, maintained and operated under the provisions of the franchise herein granted shall be commenced in good faith within not more than eight months from the date of the acceptance of said franchise, and shall be continuously prosecuted thereunder in good faith, and shall be completed within not more than three years thereafter. That the said grantee shall, in good faith, lay out and expend for material and labor used and performed in the construction of said telephone plant, system and exchange, including office and exchange buildings, poles, conduits, manholes, wires, cables, switchboards, telephonic apparatus and appliances the following sums within [fol. 155] the period hereinafter mentioned, respectively: Fifty thousand dollars ($50,000) within one year after the grant of the franchise herein provided for is passed, approved and becomes effective; one hundred and fifty thousand dollars ($150,000) within two years after the grant of the franchise herein provided for is passed, approved and becomes effective, and six hundred thousand dollars ($600,000) within three years after the grant of the franchise herein provided for is passed, approved and becomes effective.

Section 14. The Board of Public Works of the City of Spokane or other properly constituted authority thereof shall have the power and authority to inspect the manner of erecting said poles, constructing said conduits and stringing and laying said wires and carrying out the provisions of this ordinance.

Section 15. Said grantee hereby agrees and covenants to indemnify and save harmless the City of Spokane against all damages, costs and expenses whatsoever to which the said City may be subjected in consequence of the acts or neglects of grantee, its agents or servants in any manner arising from the rights and privileges granted herein.

Section 16. The rights, privileges and franchise hereby granted shall terminate at the expiration of thirty-five (35) years from the date this ordinance becomes of force and effect.

Section 17. That at any time after the expiration of ten (10) years from the date this franchise becomes effective, the City of Spokane reserves the right, at its election and upon the payment therefor of a fair valuation thereof, to be made and determined as hereinafter provided, to purchase as an entirety and take over to itself all of the property, plant, system and exchange constructed, operated and maintained under the rights conferred by this grant which may be situated on, in, above and under the streets, avenues and public places of the City of Spokane enumerated in Section 1 of this ordinance, together with all real personal and mixed property, apparatus, appliances, appurtenances of every kind and description, including [fol. 156] all choses in action, contracts, subscriptions and good will, making up, constituting and used in connection with such plant, system and exchange so operated and maintained under the rights and franchises herein granted.

In determining the valuation of said plant and property to be purchased and taken over by the city there shall be included in such valuation the value of all poles, crossarms, braces, wires, conduits, manholes, buildings, real estate, switchboards, telephones and all real, personal and mixed property, including all apparatus, appliances, appurtenances, contracts, choses in action and good will of every kind and description making up, constituting and used in connection with such plant, system, exchange and telephone and telegraph business. The price or valuation to be paid by the City of Spokane for said property, plant, system and exchange and telephone and telegraph business shall be fixed and determined by three arbitrators, one appointed by the Council of the City, another by the grantee, and the third appointed by the two so chosen, and the decision in writing of said three arbitrators, or a majority of them, made in duplicate and signed by them, one delivered to the Major of the City of Spokane and the other to the grantee, shall be final and binding upon the

parties, and said price and valuation shall be paid to the grantee hereinbefore said grantee shall be deprived of the possession or right to maintain, operate and enjoy said property, plant, system and exchange, and, upon payment by the City of said grantee of such price and valuation so determined as aforesaid, said plant and property so valued, purchased and paid for shall become the property of the City of Spokane by virtue thereof and payment therefor as aforesaid, and without the execution of any instrument of conveyance. Should said grantee neglect for a reasonable time after it has been determined that the City is authorized to and will purchase and take over said plant and property, and after notice to that effect from the City, to select an arbitrator, or in case the two arbitrators chosen [fol. 157] by the Council of the City and the grantee respectively neglect for a reasonable time after their appointment to select a third arbitrator, then, and in either of said cases, the Judges of the Supreme Court of the State of Washington shall appoint three arbitrators to determine the price or valuation to be paid for said plant and property, and the decision of said three arbitrators, or a majority of them, so chosen by the Judges of the Supreme Court, made in writing in duplicate and delivered to the parties, as aforesaid, shall be final and binding upon the parties.

Section 18. Within thirty (30) days after the passage of this ordinance the said grantee shall file with the Clerk of the City of Spokane a bond in the sum of ten thousand dollars ($10,000) with two sufficient sureties to be approved by the Mayor, conditioned:

First. That the grantee shall commence the work of constructing the plant, system and exchange to be constructed and operated under the provisions of this franchise in good faith within not more than eight months from the date of granting such franchise; and, that said work shall be prosecuted thereafter in good faith and shall be completed with a pole line and conduit ultimate capacity of not less than ten thousand (10,000) telephones, within not more than three years thereafter.

Second. That the grantee shall expend the sums of money, respectively, within the periods prescribed by Section 13 of this ordinance.

Third. That each and every street, alley or highway, or any portion thereof, that may be disturbed or torn up by said grantee under the provisions of this Ordinance shall be replaced and put in as good order and condition as the same was in before it was so disturbed or torn up, and be thereafter maintained for a period of one year.

Fourth. That the grantee shall pay all damages, costs [fol. 158] and expenses whatsoever to which the City may be subjected in consequence of the acts of negligence of grantee, its servants or agents, in any manner arising from the rights and privileges granted herein.

Fifth. That said grantee will faithfully keep and perform each and every term and condition imposed by this ordinance.

Section 19. That any neglect, failure or refusal to comply with any of the conditions of this franchise or grant may thereupon effect a forfeiture hereof, and the said City of Spokane may, by its Council, with the approval of the Mayor of said City, declare this grant and all the rights and privileges herein conferred forfeited, and upon adjudication of forfeiture by a court of competent jurisdiction, this franchise and all the privileges and rights conferred thereby shall become null and void.

Section 20. The said grantee shall, within thirty (30) days after this ordinance shall be passed and approved, file in the office of the City Clerk of the City a written acceptance of this ordinance and franchise herein granted, and the failure upon the part of the grantee herein to file such written acceptance within the time herein specified shall be deemed an abandonment and rejection of the franchise, rights and privileges herein conferred, and this ordinance shall be forever null and void, and such acceptance by grantee shall be unqualified and shall be an acceptance of all the terms, conditions and restrictions contained in this ordinance.

Submitted to a vote of the people at an election held August 11th, 1905, pursuant to Amendment No. 61 of the Charter of the City of Spokane, Washington, and adopted by the following vote: For said ordinance, 2,447 votes; against said ordinance, 387 votes.

August 18th, 1905.

G. B. Koontz, President of the City Council.

Attest: C. A. Fleming, City Clerk.

[fol. 159] State of Washington,
County of Spokane,
City of Spokane, ss:

I, H. D. Dearling, City Clerk of the City of Spokane, Washington, do hereby certify that the foregoing is a true, accurate and correct copy of that certain Ordinance No. A2118, entitled:

"An Ordinance granting to the Home Telephone & Telegraph Company of Spokane the right, privilege and franchise to erect poles and string wires and cables thereon, to construct underground conduits and manholes, and to lay wires and cables in underground conduits and through manholes, and to stretch wires and cables along, over, upon and across the streets, alleys, avenues and public places in the City of Spokane, for the transmission of sounds, signals, conversation and intelligence through and over said wires and cables, by means of electricity, and to construct, establish, equip and install a telephone and telegraph system, and to conduct a general telephone and telegraph business within the said City of Spokane, and fixing the compensation to be paid therefor,"

passed by the City Council August 18, 1905, the original of which is now on file in and a part of the records of the said City Clerk.

In Witness Whereof, I have hereunto set my hand and affixed the official seal of the said City of Spokane, Washington, this 21st day of May, A. D. 1925.

H. D. Dearling, City Clerk of the City of Spokane, Washington, by ——————, Deputy. (Seal of the city of Spokane, Washington.)

[fol. 160] EXHIBIT "B" TO ANSWER

Ordinance No. "4079"

An ordinance amending section 13 of Ordinance No. A2118, entitled "An Ordinance No. A2118, granting to the Home Telephone and Telegraph Company of Spokane, the right, privilege and franchise to erect poles and string wires and cables thereon, to construct underground conduits and manholes and to lay wires and cables in underground conduits and through manholes, and to stretch wires and cables along, over, upon and across the streets, alleys, avenues and public places in the City of Spokane, for the transmission of sounds, signals, conversation and intelligence through and over said wires and cables by means of electricity, and to construct, establish, equip and install a telephone and telegraph system, and to conduct a general telephone and telegraph business within the said City of Spokane, and fixing the compensation to be paid therefor."

The City of Spokane does ordain as follows:

Section 1. That section 13 of an Ordinance No. A2118 granting to the Home Telephone and Telegraph Company of Spokane, the right, privilege and franchise to erect poles and string wires and cables thereon, to construct underground conduits and manholes, and to lay wires and cables in underground conduits and through manholes, and to stretch wires and cables, along, over, upon and across the streets, alleys, avenues and public places in the City of Spokane, for the transmission of sounds, signals, conversation and intelligence through and over said wires and cables by means of electricity, and to construct, establish, equip and install a telephone and telegraph system, and to conduct a general telephone and telegraph business within the said City of Spokane, and fixing the compensation to be paid therefor, be amended to read as follows; viz:

Section 13. The work of constructing said telephone plant, system and exchange to be constructed, maintained and operated under the provisions of the franchise herein [fol. 161] granted, shall be completed by the 1st day of December, 1910.

Said grantee, by that date, shall lay out and expend in good faith, for material and labor used and performed in the construction of said telephone plant, system and exchange including office and exchange grounds and buildings, poles, conduits, manholes, wires, cables, switchboards, telephone apparatus and appliances, not less than six hundred thousand dollars ($600,000.00), said sum being inclusive of all moneys expended for said purpose from the commencement of said work until the completion thereof.

Passed the City Council April 13th, 1909.

E. Lambert, President of the City Council. C. Herbt. Moore, Mayor.

Attest: C. A. Fleming, City Clerk.
Approved: Apr. 14 09.

[fol. 162] State of Washington,
County of Spokane,
City of Spokane, ss:

I, H. D. Earling, City Clerk of the City of Spokane, Washington, do hereby certify that the foregoing is a true, accurate and correct copy of that certain Ordinance No. A4079, entitled:

"An Ordinance amending section 13 of Ordinance No. A2118, entitled "An ordinance, No. A2118), granting to the Home Telephone and Telegraph Company of Spokane, the right, privilege and franchise to erect poles and string wires and cables thereon, to construct underground conduits and manholes, and to lay wires and cables in underground conduits and through manholes, and to stretch wires and cables along, over, upon and across the streets, alleys, avenues and public places in the City of Spokane for the transmission of sounds, signals, conversation and intelligence through and over said wires and cables by means of electricity, and to construct, establish, equip and install a telephone and telegraph business within the said City of Spokane, and fixing the compensation to be paid therefor,"

passed the City Council April 13, 1909, the original of which is now on file in and a part of the records of the said City Clerk.

In witness whereof, I have hereunto set my hand and affixed the official seal of the said City of Spokane, Washington, this 21st day of May, A. D. 1925.

H. D. Dearling, City Clerk of the City of Spokane, Washington, by ——— ———, Deputy. (Corporate Seal.)

[fols. 163-276] State of Washington,
County of Thurston, ss:

The undersigned being first duly sworn on oath deposes and says: that on May 23rd, 1925, at Olympia, Washington, he deposited in the United States Postoffice, in a sealed envelope addressed to "Mr. Otto B. Rupp, 660-671 Colman Building, Seattle, Washington, copy of the within and foregoing joint answer of defendants to amended and supplemental — in the within entitled action.

H. C. Brodie.

Subscribed and sworn to before me this 27th day of May, 1925. Chas. O. Flint, Notary Public in and for the State of Washington, Residing at Olympia. (Seal.)

[File endorsement omitted.]

[fol. 277] In United States District Court

Report of John F. Condon, Special Master — Filed September 17, 1925

Franchise Contract as to Rates

Findings of Facts

This question is presented by the "Affirmative Answer and Defense" of the Defendants in the Pacific Company Case #166 E, set forth at pages 19 to 36 of their printed answer; and by the "Affirmative Answer and Defense" of the defendants in the Home Company Case #167 E, set forth at pages 8 to 11 of their typewritten answer. (No

printed answer is before me.) The ordinances and other acts which form the basis of the claim of a franchise contract as to rates are set forth as exhibits and attached to said answers.

As to the city of Tacoma, the Exhibits attached to Defendants' Answer in the Pacific Case were admitted by plaintiffs' counsel as pleaded and (see pp. 1909 to 1911 Tr. Test.) were as follows:

Exhibit B, being Ordinance #2522, city of Tacoma, and found at pages 56 to 67 of printed answer in the Pacific Company Case, and Exhibit B-1, being an acceptance of the franchise and Ordinance #2522 found at page 68 of said printed answer, and Exhibit B-2, being an assignment of the franchise of said Ordinance #2522 to the Pacific Telephone and Telegraph Company, being found at pages 69 to 71 of said answer and Exhibit B-3, being Ordinance #6319, consenting to the assignment of the franchise granted under Ordinance #2522 and being found at pages 72 and 73 of said printed answer.

As to the city of Seattle, Defendants' Exhibits Nos. 27, 28, 29 and 30 and Plaintiffs' Exhibits Nos. 101 and 102, all in the Pacific Case, were admitted in evidence. The allegations pleaded were not all admitted as pleaded, but [fol. 278] the evidence in relation thereto is to be found at pages 1912 to 1930 (Tr. Test.) and said exhibits were as follows:

Ordinance #6498, city of Seattle, granting a franchise to John S. McGroarty and George C. Blanker, shown as Exhibit A-1, pages 48 to 50 inclusive of said printed answer, same being also Defendants' Exhibit #27 in the Pacific Company Case. The acceptance of said ordinance is Defendants' Exhibit #28 in Pacific Case. Ordinance #7143, amending Ordinance #6498 and consenting to the transfer of the franchise to the Independent Telephone Company, shown as Exhibit A-2, at pages 51 to 55 inclusive of said printed answer, and is also Defendants' Exhibit #29 in the Pacific Case. The transfer of the franchise from the Pacific Company to F. H. Crosby is Defendants' Exhibit #30 in the Pacific Case.

As to the city of Spokane, the exhibits attached to the answer in the Home Case were admitted by plaintiffs as

pleaded, (see pages 1503 to 1505, Tr. Test.), and were as follows:

Ordinance #A2118, being Exhibit A attached to the typewritten answer of the Defendants in the Home Case, is the ordinance granting a franchise to the Home Telephone and Telegraph Company found immediately following page 11 of said typewritten answer and being marked Exhibit A and being numbered pages 1 to 12 inclusive. Ordinance #A4079, being Exhibit B and amending section 13 of said Ordinance #A2118, being marked Exhibit B and being numbered pages 1 and 2 and being found at the end of said typewritten answer.

The discussions as to this subject are found in the parties' briefs as follows:

Plaintiffs' Brief (Typewritten p. 166 and printed p. 173).
Defendants' Brief (Typewritten p. 2 and printed p. 2).
Defendants' Brief (Winston's Typewritten p. 9).
Plaintiff's Reply Brief (Typewritten p. 69 and printed p. 72).

[fol. 279] In the Public Service Commission law of 1911, passed by the legislature of this state, the Public Service Commission was authorized to modify those franchise rates and terminate them. Section 43 of the Public Service Commission Law of 1911, being Chapter 117 of the Session Laws of 1911 at page 567 and being section 10379 of Remington's Compiled Statutes, authorizes the Public Service Commission to modify franchise contracts as to rates stipulated in said contracts. Said section is as follows:

"Sec. 10379. Existing Contracts—Effect.—Nothing in this act shall be construed to prevent any telegraph company or telephone company from continuing to furnish the use of its lines, equipment or service under any contract or contracts in force at the date this act takes effect or upon the taking effect of any schedule or schedules of rates subsequently filed with the commission, as herein provided, at the rates fixed in such contract or contracts: Provided, however, that the commission shall have power, in its discretion, to direct by order that such contract or contracts shall be terminated by the telephone company or telegraph com-

pany party thereto, and thereupon such contract or contracts shall be terminated by such telephone company or telegraph company as and when directed by such order." (L. '11, p. 567, sec. 43.)

On August 1, 1918, Postmaster General took charge of Pacific and Home Telephones, under authority of a Congressional Resolution.

February 13, 1919, Public Service Commission of Washington made an order establishing the Postmaster General Rates as the rates of the Pacific Company and expressly directed a termination of the franchise rates, and a similar order was made as to the Home Company on March 20, 1919. (See Reports of Public Service Commission of Washington 1918-1919, pp. 153 to 171 as to Pacific Company and Reports of Public Service Commission of Washington, 1918, 1919, pp. 171 to 182 as to the Home Company.)

August 1, 1919, Postmaster General returned the telephones to the Pacific and Home Companies.

[fol. 280] August 8, 1919, the Public Service Commission, upon petition of the Pacific Company, entered an order granting leave to the Pacific Company to continue in effect the rates prescribed by the Postmaster General until the further order of the Commission. The Commission, in cause #3158 at pages 228 of their Report for 1918-19, waived the 30 day notice requirement for hearing of this petition. A copy of this petition and the order of the Commission is to be found at pp. 75 to 79 of Defendants' printed answer in the Pacific Case.

March 3, 1920, the order of February 13, 1919 was held invalid by the Supreme Court of Washington in State ex rel. Seattle v. Public Service Commission, 110 Wash. 130, upon the ground that the State Public Service Commission had no jurisdiction because the telephones were in charge of the Postmaster General.

The order of August 8th, 1919 does not seem to affect the Home Company. The only attempts to affect the Home Company franchise rates is the order of February 13th, 1919, which was held invalid by the Supreme Court of the State of Washington in 110 Washington 130, and the order of March 31, 1923.

I do not deem it advisable to set forth in my findings in haec verba the several exhibits heretofore referred to in

relation to this subject because I believe it will be readily conceded that the rates claimed by plaintiffs to avoid confiscation are higher than the franchise rates and the questions arising therefrom are questions of law.

Conclusions of Law

I believe that it will not be disputed that where a contract is entered into between a duly authorized municipal corporation and a public service corporation fixing rates to be charged by the latter for a definite term not grossly unreasonable in time, that the agreed rates are enforceable [fol. 281] even though they become confiscatory.

St. Cloud Public Service Commission v. St. Cloud, 265 U. S. 352

In the cases before me, I have not heard doubted the authority of the several municipal corporations involved to enter into franchise contracts with public service companies. They are all municipal corporations of the first class. The question then is, did the action of the commission in changing the franchise rates terminate the franchise rates?

The intention of the legislature of the state of Washington in the passage of the act of 1911 heretofore quoted as Remington's Compiled Statutes 10379, is shown by the following quotation from the case of State ex rel. Spokane v. Kuykendall, 119 Wash. 107, pp. 111, 112.

"By the act of 1911 (Laws of 1911, p. 561, sec. 34) the terms of a franchise contract like the one in question here are binding upon the parties until the department of public works (heretofore the public service commission) has made an order directing a departure therefrom; and, without question, the department has the right and power to order a departure. State ex rel. Ellertsen v. Home Tel. and Tel. Co., 102 Wash. 196, 172 Pac. 899; In the case of State ex rel. Webster v. Superior Court, 67 Wash. 37, 120 Pac. 861, Ann. Cas. 1913 D 78, L. R. A. 1915 C 287, it was decided that the public service commission law placed the entire subject of rate regulations under the control of the commission, that no contract between a city representing the public and a public service company would be allowed to interfere with that control, and by way of application of the rule, it was

decided in that case to be the duty of the commission to the company to fix a rate which was sufficient (a rate that would afford a fair interest return on the investment), in spite [fol. 282] of the franchise contract fixing rates which were too low. That, in legal effect, is what has been done in the present case."

It was held in State ex rel. Spokane Falls Gas Light Co. v. Kuykendall, 119 Wash. 107, that the fact that the order fixing new rates which did not in express terms terminate the franchise rates made no difference and that the order then being considered fixed rates but did not expressly terminate the franchise rates and was "just as effective as if, after fixing the rates, there had been added therein the words 'and it is hereby directed that the rates provided in the franchise shall be and they are hereby terminated,' or words of similar import. That is the legal effect of what was done and the form or language by which it was accomplished is not very material."

It seems to me, after a careful perusal of the Spokane Falls Gas Light Company v. Kuykendall, (supra), and I so conclude as a matter of law, that the effect of the action of the Public Service Commission in its order of August 8, 1919, in continuing in effect the rates established by the Postmaster General, that it did terminate the franchise rates and that after such termination the franchise rates are out of legal existence. I cannot agree with defendants' counsel in their contention that the new rate fixed by the Public Service Commission is merely an amendment of the original franchise contract and that the new rate is thereafter a contract rate.

And to the same effect is the order of March 31, 1923 as to both Pacific and Home Companies.

I believe that the fixing of the new rates by the Commission terminates the old franchise rates as far as it exists as [fol. 283-289] a contract rate, and it thereafter becomes and remains a public service commission rate, and I so conclude as a matter of law.

This is the only conclusion that will carry into effect the State's intention as expressed by the Supreme Court of Washington that the entire subject of rate regulation be placed under the control of the public service commission, and that no contract between a city representing the public and the public service company would be allowed to interfere with that control.

See State ex rel. Spokane v. Kuykendall (supra).

And I do not believe that this conclusion is in any way affected by the rather recent ruling of the Supreme Court of Washington in the case of Monroe Water Works v. Monroe, decided July 15, 1925, and reported in volume 35 of Washington Decisions at page 232 and in volume 237 Pacific Reporter at page 996.

[fols. 290-295] In United States District Court

Exceptions to Report of Special Master—Filed October 1, 1925

Come now the defendant in the above entitled cause, and except to the report of John T. Condon, the special master in chancery, appointed by this court, which report was returned to the clerk's office of said district court on the 15th day of September, 1925, and allege the following grounds for exception:

* * * * * * *

[fol. 296] 15

They except to the conclusion of the Master (p. 120, 121), (p. 136 printed copy), that the orders of the department of public works, one of February 13, 1919, and one of March 31, 1923, being the order under review, terminated the franchise rates, for the reason that the same is contrary to law. The first order referred to was invalid because of lack of jurisdiction. The second order referred to did not change in any manner the existing rates. The said conclusion of the Master fails to give proper effect to the state statute and fails to conclude, as it should, that a franchise contract exists between the complainant and the city of Spokane. It assumes jurisdiction to be in the Federal [fols. 297 & 298] court by virtue of the confiscation clause of the Federal Constitution. Said franchise rates can only be further modified by the department of public works in the manner provided by statute.

* * * * * * *

[fols. 299 & 300] 19

They except to the conclusion of the Master, (p. 126), (p. 143 printed copy), that the temporary injunction heretofore granted in this case be made permanent, for the reason that the same is contrary to the law and the evidence, for the specific reasons assigned in preceding exceptions.

20

They further except to the conclusion of the Master, (p. 126), (p. 143 printed copy), that the temporary injunction be made permanent, for the reason that such conclusion is wholly unsupported by the findings or conclusions of the Master with respect to the effect of said order, on the property and revenues of the plaintiff, subsequent to June 30, 1922, and is wholly unsupported by any finding or conclusion of the Master that the property of the plaintiff has been confiscated since June 30, 1922, or is now being confiscated by reason of any order of the department of public works. (Amended and Supp. Compt. Pars. XIX & XXI.)

Dated this 30th day of September, 1925.

John H. Dunbar, Attorney General of the State of Washington; H. C. Brodie, Assistant Attorney General of the State of Washington, Solicitors for Defendants. J. M. Geraghty, Alex. M. Winston, of Counsel.

[fol. 301] In United States District Court

[Title omitted]

Before Rudkin, Circuit Judge, and Neterer and Webster, District Judges

Opinion—Filed April 22, 1926

Webster, District Judge:

These cases, by agreement of counsel consolidated for [fol. 302] the purpose of taking testimony before the Special Master, have been dealt with by him in a single report,

and will therefore be considered together. No attempt will be made to detail the history of this complicated and protracted litigation as it has taken its course through State and Federal Courts. For the purpose of our present inquiries it will perhaps suffice to say that on March 31, 1923, the Department of Public Works of the State of Washington (hereinafter called the Department) made two orders affecting these plaintiffs, one purporting to determine for rate making purposes the value of the property of the Home Telephone and Telegraph Company of Spokane (hereinafter called the Home Company), and the other a like order fixing the value of both the intrastate and interstate property of the Pacific Telephone and Telegraph Company (hereinafter called the Pacific Company). A few days later these suits were commenced by these two companies, alleging that the rate orders promulgated by the Department were confiscatory of the property of the companies respectively, and consequently in violation of the Federal Constitution. The cases are now before the Court pursuant to Section 266 of the Judicial Code as amended upon exceptions to the report of the Special Master, to whom the cases were in due course referred.

The Special Master found the fair and reasonable value of the Pacific Company's intrastate property devoted to the public service, as of June 30, 1922, to be $31,425,403.75 including average working capital; to which there should be added $720,000.00 found to be the "going concern value" of that Company's property, making a total value or rate basis on which that Company was entitled to a fair and reasonable return of $32,145,403.75; and the equivalent figure for the Home Company was fixed at $4,548,021.76. The [fol. 303] Special Master further found the fair and reasonable rate of return which the companies were entitled to earn as of June 30, 1922, to be seven and one half per centum per annum. In addition he found that the net revenue of the Pacific Company as of June 30, 1922, was $928,081.97, and the corresponding figure for the Home Company was $126,081.97, on the basis of the rates then allowed, and that these revenues would produce a return of less than three per centum per annum for each company. From these findings he concluded as a matter of law that the effect of enforcing the orders of the Department complained of

would be to confiscate the property of the companies respectively, and recommended that a permanent injunction be granted restraining the Department from putting such orders into effect. The correctness of these Findings and Conclusions is now challenged by exceptions, which give rise to the following principal questions:

One. What is the fair and reasonable value of the properties of the two companies respectively which is held for and used in the public service—that is to say, what is the proper value of such properties as the lawful basis for a rate structure.

Two. In determining this, should working capital be allowed.

Three. Should "going concern value" be taken into account, and if so, how should such amount be ascertained.

Four. What amount should properly be deducted for depreciation, and how is this amount to be arrived at.

Five. Are the licenses contracts involved valid and to be given their face effect.

And, finally, what was a proper rate of return to be allowed each Company upon the property devoted by it to the public use as of June 30, 1922.

The subordinate and incidental problems to which these major considerations necessarily give rise will be noticed in their proper places and connections.

At the threshold we face the query—what were the physical properties of the companies respectively as of June 30, 1922? During 1913, 1914 and 1915, at a cost of approximately $125,000.00, the Pacific Company made a detailed and complete inventory of all its property in the State of Washington. As to central office equipment, buildings, and certain other important items of property an actual field count and appraisal was made. In case of other classes of property as careful and accurate a survey was made as of the nature of the millions of small items comprising it rendered practicable. This inventory and appraisal consisted of fifty four volumes containing an average of four hundred pages each. It was completed in the early part of 1915, and subsequently was brought down to December 31, 1921, by a

system of accounting as advocated by various and numerous text books. The work was in charge of an expert in such matters, who testified: "It is a close a determination of the precise facts as it is humanly possible to make it." There is little in the record challenging the correctness of appraisal and the Special Master was amply justified in finding that it is as accurate, thorough and complete as it is practical to make it, and is all that should in reason be required. The cost of reproducing the property of the Home Company, with the exception of its going concern value, was stipulated by the parties and therefore needs no discussion. Taking then the detailed inventory and the stipulation as the basis of the physical properties of the two companies, we pass naturally to the ascertainment of [fol. 26] the proper rules to be followed, the proper elements and factors to be considered, in fixing the value of such property for rate making purposes.

In Smyth v. Ames, 169 U. S. 466, pp. 546-547, the Supreme Court said:

"We hold, however, that the basis of all calculations as to the reasonableness of rates to be charged by a corporation maintaining a highway under legislative control must be the fair value of the property being used by it for the convenience of the public. And in order to ascertain that value the original cost of construction, the amount sacrificed in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case. We do not say that there may not be other matters to be regarded in estimating the value of the property. What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience."

In Willcox v. Consolidated Gas Company, 212 U. S. 19, p. 52, the Supreme Court said:

"If the property, which legally enters into the consideration of the question of rates, has increased in value since it was acquired, the company is entitled to the benefit of such

increase. This is, at any rate, the general rule. We do not say there may not possibly be an exception to it, etc."
[fol. 306] In the Minnesota Rate Cases, 230 U. S. 352, p. 456, this principle is stated:

"The property is held in private ownership and it is that property, and not the original cost of it, of which the owner may not be deprived without due process of law."

In Missouri ex rel. Southwestern Bell Telephone Company v. Public Service Commission, 262 U. S. 276, the Public Service Commission undertook to value the property there involved without according any weight to the greatly enhanced cost of material, labor and supplies. In reviewing this action, at page 287 of the opinion, the Court said:

"It is impossible to ascertain what will amount to fair return upon properties devoted to public service without giving consideration to the cost of labor, supplies, etc., at the time the investigation is made. An honest and intelligent forecast of probable future values made upon a view of all the relevant circumstances, is essential. If the highly important element of present costs is wholly disregarded such a forecast becomes impossible. Estimates for tomorrow cannot ignore prices of today."

In Winfield Water Works and Improvement Company v. Public Service Commission, 262 U. S. 679, p. 689, this language is found:

"The record clearly shows that the commission in arriving at its final figure did not accord proper, if any, weight to the greatly enhanced costs of construction in 1920 over those prevailing about 1913 and before the war, as established by uncontradicted evidence; and the company's detailed estimated cost of reproduction new, less depreciation, [fol. 307] at 1920 prices, appears to have been wholly disregarded. This was erroneous."

Federal and State cases holding to the same view almost without number might be cited. It is true that in the case of Georgia Railway and Power Company v. Railroad Commission, 262 U. S. 625, the Supreme Court said:

"The refusal of the Commission and of the lower court to hold that, for rate-making purposes, the physical prop-

erties of a utility must be valued at the replacement cost less depreciation was clearly correct."

The facts of this case, however, and its subsequent history, clearly indicate that the reason for this statement was that at the time of making the estimation of values the prices prevailing were abnormal or peak prices which afforded no true or just criterion of reproduction costs under stable or normal economic conditions. Plainly, the rule of reproduction cost less depreciation is not an invariable and inflexible one, to be arbitrarily applied in all cases without regard to other factors and elements. To be sure, there must be no slavish adherence to it. Like most general rules it has exceptions, limitations, and qualifications, and must always be applied to concrete facts with due regard for the fundamental consideration that the utmost any public utility can rightfully demand at the hands of rate making bodies is such compensation for the use of its property as will, under all the circumstances existing at the time, be just, both to it and to the public. A careful study of the cases, however, leads unerringly to the conclusion that one of the most important factors, if not the dominant factor, in determining the true basis of rate making for [fol. 208] public utilities is the cost of reproduction new less depreciation of the property of the utility devoted to the public convenience, at the time of making the rates, provided such cost fairly reflects normal and stable prices prevailing at the time, and also prices which will with reasonable certainty continue to prevail throughout the period covered by the rates fixed, so far as reasonable human foresight, measuring the future by the present and the past, can determine. This is what the utility is supplying for the public service, and it is this of which it would be unjustly deprived by confiscatory rates, fares, tolls, or charges.

There is practically no controversy concerning the original cost of the properties of the two companies. This [illegible] as effect stipulated by the parties.

The Department, in its orders of March 31, 1923, which gave rise to this litigation, took for the basis of its promulgated rates the original cost of the properties to the companies respectively, and gave no consideration to any other elements or factors of value, this being done on the prudent

investment theory which the decisions of the Supreme Court of Washington seem to hold is the method required by the state statute defining the powers of the Department.

Pacific Coast Elevator Company v. Department, 130 Wash. 620.

State ex rel. Spokane Gas Company v. Kuykendall, 119 Wash. 107.

This method of valuation was rejected by the Special Master. In its stead he applied the rules announced in Smyth v. Ames, supra, as explained and qualified by the later holdings of the Supreme Court, attaching no importance to the factor of the value of stocks and bonds upon the authority of the Minnesota Rate Cases, supra. In so [fol. 309] doing he was clearly right. Granting the correctness of the method employed, there is little room for criticism of his calculations and conclusions as to the fair and reasonable value of the properties of the companies. No useful purpose would be served by following the labyrinth of details involved in his extremely burdensome task.

We pass now to the question of depreciation. From the cost of reproducing new the properties of the companies must be deducted depreciation, representing the difference between new property and property in the condition it was at the time of the estimate. How should this be done? In the case of the Home Company the amount of depreciation is stipulated, hence calls for no discussion. The question of depreciation in the case of the Pacific Company presents a more difficult problem. The proper method for determining depreciation seems now quite well settled. In Pacific Gas and Electric Company v. City and County of San Francisco, 265 U. S. 403, p. 436, the Supreme Court said:

"Appellant objects to the application of this method and insists that depreciation should have been ascertained upon full consideration of the definite testimony given by competent experts who examined the structural units, spoke concerning observed conditions and made estimates therefrom. As these examinations were made subsequent to the alleged depreciation for the definite purpose of ascertaining exist-

ing facts, we think the criticism is not without merit. Facts shown by reliable evidence were preferable to averages based upon assumed probabilities."

In other words, it was held that accrued depreciation is to be ascertained by an inspection of the property—by going [fol. 310] and looking at it and making estimates based upon the facts which such examination discloses.

To the same effect see:

New York Telephone Company v. Prendergast, 300 Fed. 822.

Southern Bell Telephone and Telegraph Company v. Railroad Commission, 5 Fed. (2d) 77.

Westinghouse Electric & Mfg. Company v. Denver Tramway Company, 3 Fed. (2d) 205.

Landon v. Court of Industrial Relations, 269 Fed. 433.

On the question of depreciation the companies produced witnesses Blanck and Fleager, while the defendants called on this point witnesses Hill, Wray and Green. The Special Master, with commendable painstaking and scrutiny, examined the conflicting evidence and concluded that the testimony of witnesses Blanck and Fleager, in view of their superior experience and opportunities, and notwithstanding the fact that they were employees of the Pacific Company, was the more satisfactory, convincing and dependable. The record convinces us that he was justified in taking this view of the matter. To undertake to fortify this conclusion by minute analysis of the voluminous record would but serve unduly to lengthen this opinion without giving it added value.

It seems plain from the record, and the Special Master so found, that the three and one half per centum per annum of the depreciable property of the companies fixed by the Department was not sufficient to take care of the actual depreciation which was bound to occur, and was intentionally fixed at a lesser amount for the purpose of reducing what it conceived to be an excessive depreciation reserve fund. [fol. 311] Such a method finds little support in law or reason. The depreciation to be taken into account in ascertaining the rate base is that diminution in the value of the

property involved which takes place in the physical thing and is ascertained by a physical inspection of it—not the future depreciation which inevitably comes about by wear, tear, obsolescence, and the like. The ascertainment of the amounts necessary for the latter purpose sheds no light on the present value of the properties of the companies for the purpose of present rate making. Indeed, it was not fixed by the Department for any such purpose. The precise question of whether it is permissible for a rate making body to reduce what it considers an excessive depreciation reserve fund by making inadequate provision for future depreciation was considered in New York Telephone Company v. Board of Public Utility Commissioners, 5 Fed. (2d) 245, and the practice was condemned.

The amount of average working capital of both companies was stipulated by the parties and was properly taken into account by the Special Master under the authorities already cited.

In the hearing before the Special Master it was not disputed that in a case presenting proper proof thereof "going value," "going concern value," or "value of plant in successful operation" (which are synonymous terms) should be taken into account. The Special Master aptly defines this item in the following language:

"This is the additional value that a purchaser will give for the properties and business of the companies because they are going concerns with established business. * * * This additional value, over and above the fair and reasonable value of the physical properties plus the working capital, which a customer would pay for the property be- [fol. 312] cause it is a going concern, and which additional value we call 'going value,' does not depend upon past losses in operations, successfully survived, or in expenditures, wisely made, contributing to 'going value,' but they are not the measure of the amount of 'going value.'"

He studiously avoided making any allowance for development cost and likewise repudiated the theory of capitalization of the net balance of alleged past deficits. He rightly held that this item of value rests largely in competent or expert opinion, and accepted in the case of the Pacific Company the amount testified to by the defendants' expert, Mr.

Green. Under the authorities there can be little doubt as to the correctness of his action in this respect. As to the amount allowed, the defendants' view was accepted and they are in no position to complain. For cases discussing going value and the propriety of its allowance as an intangible part of the rate base, see:

Galveston Electric Company v. Galveston, 258 U. S. 388.

Houston v. Southwestern Bell Telephone Company, 259 U. S. 318.

Georgia Railway and Power Company v. Railroad Commission, 262 U. S. 625.

Mobile Gas Company v. Patterson, et al., 293 Fed. 208.

Pacific Gas and Electric Company v. San Francisco, 273 Fed. 937.

In the case of the Home Company, for want of proper proof, no allowance of going concern value was made.

We pass now to a consideration of the licensee or so-called four and one-half per cent. contracts. These are [fol. 313] contracts whereby the Pacific Company and the Home Company pay to the American Telephone and Telegraph Company four and one-half per cent. of the gross revenues of the companies respectively, for which the American Company supplies to the Pacific Company and the Home Company certain instrumentalities, appliances, patents, and services, not necessary to detail. The Department, in its orders of March 31, 1923, held that these contracts were wrong in principle and contrary to public policy, and substituted in lieu of the percentage of revenue payment as provided in the contracts an annual per station charge of ninety cents. The Special Master took proof touching the validity of these contracts and found as a fact that they were of great value to the Pacific and Home companies as well as to the public, and were not contaminated with fraud or bad faith. As a matter of law he concluded that they were valid obligations, and the amounts paid under them lawful expenditures. As we read the cases, the question presented by this aspect of the case has been foreclosed by the Supreme Court. In Houston v. South-

western Bell Telephone Company, 259 U. S. 318, p. 323, the court said:

"The American Telephone and Telegraph Company owns substantially all of the stock of the Company and a large majority of the stock of the Western Electric Company. From the American Telephone & Telegraph Company the Company leases its instruments and secures their maintenance and renewal, and from the Western Electric Company it obtains the greater part of its equipment and supplies used in operating its local exchange. It is contended by the City that no fair disclosure was made of the profits made by the furnishing companies on the instruments and on the material and supplies so furnished and that, for this [fol. 314] unique reason, the Company should not be heard in a court of equity and the case should be dismissed. It is true that the Company did not introduce proof to show what the profits of the two companies were, either upon the business done with it or on their entire business, but it did introduce much evidence tending to show that the charges made and allowed for the services rendered and supplies furnished by them was reasonable and less than the same could be obtained for from other sources. Under the circumstances disclosed in the evidence, the fact that the American Telephone & Telegraph Company controlled the company and the Western Electric Company by stock ownership is not important beyond requiring close scrutiny of their dealings to prevent imposition upon the community served by the Company, but the court recognized and applied this rule. Here again, the evidence introduced by the City was meager and indefinite, while that of the Company was exceptionally full and complete, and both contentions must be denied."

Again, in State of Missouri ex rel. v. Public Service Commission, 262 U. S. 276, 288, in dealing with those contracts the Court said:

"The important item of expense disallowed by the Commission—$174,948.00—is 55% of the 4½% of gross revenues paid by plaintiff in error to the American Telephone & Telegraph Company as rents for receivers, transmitters, induction coils, etc., and for licenses and services under the customary form of contract between the latter

company and its subsidiaries. Four and one-half per cent. is the ordinary charge paid voluntarily by local companies of the general system. There is nothing to indicate bad faith. So far as appears, plaintiff in error's board of di- [fol. 315] rectors has exercised a proper discretion about this matter requiring business judgment. It must never be forgotten that while the State may regulate with a view to enforcing reasonable rates and charges, it is not the owner of the property of public utility companies and is not clothed with the general power of management incident to ownership. The applicable general rule is well expressed in State Public Utilities Commission ex rel. Springfield v. Springfield Gas and Electric Company, 291 Ill. 209, 234.

"'The commission is not the financial manager of the corporation and it is not empowered to substitute its judgment for that of the directors of the corporation; nor can it ignore items charged by the utility as operating expenses unless there is an abuse of discretion in that regard by the corporate officers.'"

For additional cases to the same effect, see:

State v. Southwestern Bell Telephone Company (Kansas), 223 Pac. 771.

Indiana Bell Telephone Company v. Public Service Commission, 300 Fed. 190.

Chesapeake and Potomac Telephone Company v. Whitman, 3 Fed. (2d) 938.

Southern Bell Telephone and Telegraph Company v. Railroad Commision, 5 Fed. (2d) 77.

Northwestern Bell Telephone Company v. Spillman, 6 Fed. (2d) 663.

Cincinnati v. Public Utility Commissioners, 149 N. E. 817.

An examination of the foregoing cases leaves no doubt as to the validity of those contracts and that the amounts paid under them are properly chargeable to operating expenses. [fol. 316] At this point it seems convenient to consider the contention of counsel that the Pacific and Home Companies are bound by the orders of the Department entered on March 31, 1923, because in the case of the Pacific Company it did not appeal to the State Courts as provided by the

State statute, and in the case of the Home Company it did not prosecute its appeal in time. Prior to March 31, 1923, however, the Supreme Court of Washington had construed the state statute as meaning that in fixing valuations for rate purposes the Department should not recognize the theory of reproduction new less depreciation, but was confined to the cost method prescribed by the statute.

State ex rel. City of Spokane v. Kuykendall, 119 Wash. 107.

And on September 22, 1924, subsequent to the orders complained of, in Pacific Coast Elevator Company v. Department, 130 Wash. 620, this holding was approved and redeclared. It is obvious therefore that an appeal to the State Courts by the companies would have been an idle and useless formality. Moreover, the plaintiffs here are seeking relief against the orders of the Department upon the ground that such orders are confiscatory, and therefore in violation of the Federal Constitution. In such a case it is clear that the Federal tribunals are not bound by the action of the State Department, but it is their imperative duty to exercise an independent judgment on both law and facts. It has been pointedly so held in a number of cases.

Bluefield Company v. Public Service Commission, 262 U. S. 679.

[fol. 317] Ohio Valley Water Company v. Ben Avon Borough, 253 U. S. 287.

Monroe Gaslight and Fuel Company v. Public Utilities Commission, 292 Fed. 139.

Van Wert Gaslight Company v. Public Utilities Commission, 299 Fed. 670.

With respect to the question of the proper rate of return to be taken into consideration in determining whether the orders of the Department complained of are confiscatory, the Special Master concluded that a return of less than seven and one-half per centum upon the fair value of the property, plus working capital and going concern value, would be confiscatory. The principles to be applied in determining what constitutes a confiscatory rate are stated by the Supreme Court in the Bluefield case, supra, as follows:

"What annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts. A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public [fol. 318] duties. A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally."

After reviewing former decisions of the courts dealing with the question, the Court uses this language:

"Investors take into account the result of past operations, especially in recent years, when determining the terms upon which they will invest in such an undertaking. Low, uncertain or irregular income makes for low prices for the securities of the utility and higher rates of interest to be demanded by investors. The fact that the company may not insist as a matter of constitutional right that past losses be made up by rates to be applied in the present and future tends to weaken credit, and the fact that the utility is protected against being compelled to serve for confiscatory rates tends to support it."

The conclusion reached was that a rate of return of six per centum upon the value of the property was substantially too low to constitute just compensation for the use of the property employed in rendering the public service. This opinion was handed down June 11, 1923. In the South-

western Bell Telephone Company case, 262 U. S. 276, p. 288, decided May 21, 1923, the Supreme Court said:

"That 6% should be allowed for depreciation appears to be accepted by the Commission. Deducting this would leave a possible 5 1/3% return upon the minimum value of the property, which is wholly inadequate considering the character of the investment and interest rates then prevailing."

[fol. 319] In Pacific Gas and Electric Company v. City and County of San Francisco, 265 U. S. 403, decided June 2, 1924, the Master in Chancery had held that any rate of return less than seven per centum would be confiscatory. In reviewing this point, at page 405, the Supreme Court said:

"We think the evidence supports the finding that a net return of seven per centum was necessary in order to avoid confiscation."

In Consolidated Gas Company v. Prendergast, 6 Fed. (2d) 243, Judge Winslow upheld a rate of eight per cent. In Kings County Lighting Company v. Prendergast, 7 Fed. (2d) 192, a statutory three-judge court made up of Judges Manton, Campbell and Inch, approved a rate of eight per cent. In Indiana Bell Telephone Company v. Public Service Commission, 300 Fed. 180, a rate of eight per cent was sustained. In State v. Southwestern Bell Telephone Company, 223 Pac. 771, the Supreme Court of Kansas upheld a rate of eight per cent. We have noticed these cases particularly for the purpose of showing the trend of thought touching this matter, as disclosed by the latest expressions of the courts in various parts of the country. There was competent and reliable evidence amply supporting the conclusion of the Special Master. The proper principles, as defined by the courts, were applied, and the figure fixed by him was within the limits marked by the controlling cases. Moreover, this Court is not engaged in the task of fixing rates for public utilities, and even if it be thought that the rate of return fixed by the Special Master is excessive, it is obvious that, measured by a substantially lower rate of return, the orders of the Department here under review [fol. 320] would nevertheless be confiscatory, because of the improper rate base adopted by the Department.

In behalf of the cities of Seattle, Tacoma and Spokane, it is contended that the plaintiff companies are entitled to no relief because in these cities the companies were operating under franchises which prescribed rates substantially lower than those allowed by the Department, and that the franchise rates are controlling, particularly since the Department did not expressly and in pointed terms abrogate and cancel them. It cannot be doubted that where a franchise contract is entered into between a municipality and a public utility corporation fixing rates to be charged by the latter for a not grossly unreasonable period of time, such rates are binding and enforceable, even though confiscatory of the property involved.

> St. Cloud Public Service Company v. City of St. Cloud, 265 U. S. 352.

Nor can it be doubted that under the statutes of the State of Washington the Department has the power to abrogate and cancel such franchise rates if in a proper case it sees fit to do so. Section 10379 of Remington's Compiled Statutes of Washington provides:

"Nothing in this act shall be construed to prevent any telegraph company or telephone company from continuing to furnish the use of its lines, equipment or service under any contract or contracts in force at the date this act takes effect or upon the taking effect of any schedule or schedules of rates subsequently filed with the commission, as herein provided, at the rates fixed in such contract or contracts; Provided, however, that the commission shall have [fol. 321] power, in its discretion, to direct by order that such contract or contracts shall be terminated by the telephone company or telegraph company party thereto, and thereupon such contract or contracts shall be terminated by such telephone company or telegraph company as and when directed by such order. (L. '11, p. 567, sec. 43.)"

Construing this statute in the case of State ex rel. Spokane v. Kuykendall, 119 Wash. 107, pp. 111-112, the Supreme Court of Washington said:

"By the act of 1911 (Laws of 1911, p. 561, par. 34) the terms of a franchise contract like the one in question here

are binding upon the parties until the department of public works (heretofore the public service commission) has made an order directing a departure therefrom; and, without question, the department has the right and power to order a departure. State ex rel. Ellerton v. Home Tel. & Tel. Co., 102 Wash. 196, 172 Pac. 909. In the case of State ex rel. Webster v. Superior Court, 67 Wash. 37, 120 Pac. 861, Ann. Cas. 1913B 78, L. R. A. 1916C 207, it was decided that the public service commission law placed the entire subject of rate regulation under the control of the commission, that no contract between a city representing the public and a public service company would be allowed to interfere with that control, and by way of application of the rule, it was decided in that case to be a duty of the commission to the company to fix a rate which was sufficient (a rate that would afford a fair interest return on the investment), in spite of the franchise contract fixing rates which were too low. That, in legal effect, is what has been done in the present case."

In this same case the point was urged that the Department, in fixing the new rates, did not in express terms [fol. 322] cancel and terminate the franchise rates. In meeting this contention the Court said:

"The present order of the department of public works is just as effective as if, after fixing the rates, there had been added therein the words 'and it is hereby directed that the rates provided in the franchise shall be and they are hereby terminated,' or words of similar import. That is the legal effect of what was done, and the form or language by which it was accomplished is not very material."

This holding is the construction of a state statute by the court of last resort of the state, and consequently is binding upon this court. The Special Master concluded that the order of the Public Service Commission (now the Department of Public Works) entered on August 6, 1918, and after the termination of federal control of the properties, continuing in effect the rates established by the Postmaster General so far as the Pacific Company is concerned, and the orders of the Department to the same effect

[illegible] on March 18, 1925, as to both the Pacific and the [illegible] Company, and the effect of terminating and abrogating the franchise ports, and that the ports established by the Department in their stead become "Department" or "statutory" ports, as distinguished from "franchise" or "contract" ports. In this, no ports will be [illegible]

[illegible] v. [illegible],

[illegible] that the Department was not obliged to grant any relief against the ports established in the franchises, and that it could not by judicial action be compelled to do so. For, if it undertakes to terminate such ports [illegible] pursuant to its plain statutory powers, the ports [illegible] must be free, just and reasonable. If the plain mandate of the statute forbids the latter it is to be obeyed. And when the [illegible] ports are challenged they must be considered as statutory — not franchise — ports, and their character as being confiscatory, or not, must be measured by the principles of law applicable to such ports.

Voluntary effort is made upon the Pacific Company's [illegible] of existing maritime commerce for one to the [illegible] of Seattle. It is asserted that the ratios are unnecessary, unreasonable and injurious. The Department, in the Pacific Company order of March 18, 1925, expressly found "the installation of maritime services to Seattle to [illegible] find." There is no evidence in the record which would warrant a contrary conclusion. Seattle is a progressive and rapidly growing city. Facilities which are equal to the present requirements may be grossly inadequate in the reasonably near future. Public service companies cannot wait until their facilities have been or prove unequal to the demands upon them before making needful additions and improvements. Business judgment must be employed to anticipate reasonably future needs and to make provision for them in advance. This is essentially a matter of business management which may not be arbitrarily interfered with. There is nothing in the ratios to suggest dishonest, wasteful or improvident operations. The right of a public utility corporation honestly and in good faith to carry on its business and direct its affairs must not be arbitrarily frustrated under the guise of rate making. In the absence of evi-

driven to the contrary, movement may reasonably be assumed to have been made in the exercise of reasonable judgment.

[Ind.][Ill.] Missouri ex rel. v. Public Service Commission supra.

See also:

Northwestern Bell Telephone Company v. Spellman, 6 Fed. (2) 483.

The finding of the Special Master that this expenditure was judicious and proper is clearly right.

[illegible] for the City of Spokane with great earnestness complains of the allocation of toll line charges made as between the Home Company and the Pacific Company. It is contended that the amount received by the Home Company is substantially less than the actual cost of supplying the service. It is further contended that the arrangement is unreasonable. It is not apparent to us, however, how relief against that situation may be granted in this case. It appears, nevertheless, that contracts of the same kind and in fact contracts less favorable to the small companies are usually entered into all over the country by telephone companies, including independent as well as subsidiary companies. That such a division of the joint tolls, in spite of superficial appearances to the contrary, is not unfair or unreasonable would seem to be sustained by the fact that it embodies the customary and usual method of adjustment adopted by the parties, dealing in the light of practical experience in such matters.

City of Spokane v. Northwestern Bell Telephone Company, 268 F. 3, 12, p. 122

The Special Master found that in view of all pertinent considerations the contract was of great benefit to the Home Tel. [illegible] Company and its patrons. We do not find [illegible] in disturbing that finding.

For the foregoing reasons, the exceptions to the report of the Special Master will be overruled, and the permanent injunction recommended by him will be granted. A decree accordingly may be presented. Before finally passing the

determine the amount of allowance to cover the services of the Special Master will be determined.

[File endorsement omitted.]

[fol. 130] IN THE UNITED STATES DISTRICT COURT

[Title omitted]

DECREE—Filed May 19, 1926

This cause came on to be heard on the 21st day of November 1925, upon the report of the Special Master, John T. Condon, duly discharged, the exceptions of the parties thereto was argued by counsel for the respective parties and was then submitted, and having been duly considered, it is now ordered, adjudged and decreed as follows:

I

That each and all of the defendants' exceptions be and they are hereby overruled.

II

That the plaintiff's exceptions be and they are hereby overruled.

III

That the rates and charges prescribed by the Department of Public Works of the State of Washington, which said rates and charges are set forth in a certain schedule, a copy thereof is attached to the amended and supplemental complaint in the above entitled cause and marked Exhibit "A" be and they hereby are decreed to be confiscatory in violation [fol. 131] thereof of the Constitution of the United States; and that the order of said Department of Public Works approving said rates and charges made on March 31, 1925, a copy of which said order is attached to the amended and supplemental complaint in the above entitled cause and marked Exhibit "B", be and the same hereby is decreed to be void and of no effect.

IV

That said defendants, and each of them, their successors in office and all others persons, be and they are hereby forever restrained and enjoined—

First. From any attempt to compel the plaintiff, its officers, agents and employees, to observe, maintain or keep in force the rates, tariffs and charges prescribed by said Department of Public Works as set forth in said schedule Exhibit "A" or from any attempt to compel the plaintiff to continue to observe or maintain said rates and charges.

Second. From any attempt to interfere with or prevent the plaintiff, its directors, officers, agents and employees from charging and collecting the rates and charges set forth in a certain schedule, a copy of which is attached to the amended and supplemental complaint in the above entitled cause and marked Exhibit "F," until just and reasonable schedules of rates and charges are established by law.

Third. From taking any steps or proceedings against the plaintiff, its directors, officers, agents or employees to enforce any penalty or remedy against the plaintiff, its directors, officers, agents or employees for disregarding the rates and charges set forth in said Exhibit "A" or for charging and collecting the rates and charges set forth in said Exhibit "F" until just and reasonable schedules of rates and charges are established by law.

Fourth. That all bonds given by the plaintiff herein pursuant to the terms and conditions of the interlocutory in[fol. 328] junction entered in this cause on the 23rd day of July, 1924, are hereby cancelled and discharged and the plaintiff and its sureties are thereon are hereby released and discharged from all liability thereon.

Fifth. That plaintiff recover of the defendants and have judgment for its costs in this suit taxed at $8,972.07 including therein the sum of Four Thousand and no 100 Dollars heretofore allowed by this court as the fee of the Special Master, and which said sum has been theretofore paid by

the plaintiff to Marian Clark Condon, executrix of the estate of John T. Condon, deceased.

To all of which defendants except.

Done in open court this 18 day of May, 1926.

Frank H. Rudkin, Circuit Judge. Jeremiah Neterer, District Judge. J. Stanley Webster, District Judge.

[File endorsement omitted.]

[fol. 329] In United States District Court

[Title omitted]

Order of Substitution—Filed August 17, 1926

Now on this day the application of defendants to substitute O. O. Calderhead as Supervisor of Transportation in place of Frank R. Spinning and C. Rea Moore as Supervisor of Public Utilities of Washington in place of O. O. Calderhead as defendants in the above entitled cause came on to be heard, and it appearing to the court that the notice of motion for substitution and the affidavit of H. C. Brodie, one of the solicitors for defendants, have heretofore been filed in this court and served upon Otto B. Rupp, Post Russell & Higgins and Pillsbury, Madison & Sutor, solicitors for plaintiff, and the court having listened to the arguments of counsel, it is Ordered that O. O. Calderhead, the Supervisor of Transportation of Washington, be and he hereby is substituted as defendant herein in place of Frank R. Spinning, who on July 31, 1925 resigned said office; and that C. Rea Moore, the Supervisor of Public Utilities of Washington be and he hereby is substituted as defendant in place of O. O. Calderhead, who on August 1, 1925 resigned said office to accept the office of Supervisor of Transportation; all without prejudice to the proceedings [fol. 330] already had in this action.

Done in open court this 16 day of August, 1926.

Jeremiah Neterer, Judge.

[File endorsement omitted.]

[fol. 331] IN UNITED STATES DISTRICT COURT

[Title omitted]

ASSIGNMENT OF ERROR—Filed August 17, 1926

Come now John C. Denney, as Director of Public Works of Washington, O. O. Calderhead, as Supervisor of Transportation of Washington, and C. Rea Moore, as Supervisor of Public Utilities of Washington, the persons constituting the Department of Public Works of the State of Washington, and John H. Dunbar, Attorney General of the State of Washington, defendants in the above entitled cause, and file the following assignment of errors on which they will rely on their appeal from the decree entered in the above entitled cause on the 18th day of May, 1926:

I

The court erred in making and entering the decree of May 18, 1926.

[fol. 332]

II

The court erred in overruling defendants' exception No. 15, to the report of the master.

III

The court erred in overruling defendants' exception No. 19, to the report of the master.

IV

The court erred in overruling defendants' exception No. 20, to the report of the master.

V

The court erred in not finding that the plaintiff is now, and has been ever since the beginning of this action, operating its exchange in the City of Spokane under a valid franchise contract, which prescribed a maximum schedule of rates for both business and residence telephones, and which franchise rates as modified by the orders of the defendants and their predecessors in office, were and are less than the rates prescribed in the schedule attached to the amended and supplemental bill of complaint herein, and that for that

reason, the orders of the predecessors in interest of the defendants did not deprive plaintiff of its property without due process of law and did not deny to plaintiff the equal protection of the law in violation of its rights under the Fourteenth Amendment of the Constitution of the United States.

VI

The court erred in finding that the order of the Department of Public Works referred to in defendants' exception No. 15, to the conclusion of the master under date February 13, 1919, terminated the franchise contract between the plaintiff and the city of Spokane for the reason that said order was invalid for lack of jurisdiction.

[fol. 333]

VII

The court erred in finding that the order of the defendants' predecessors in office, of date March 31st, 1923 being the order under review, terminated the franchise contract between the plaintiff and the City of Spokane, for the reason that said order did not attempt in any manner to change the then existing rates.

VIII

The court erred in holding that Section 10379 of Remington's Compiled Statutes of the State of Washington, authorized the defendants' predecessors in office to terminate the franchise contract existing between plaintiff and the City of Spokane because of an alleged construction of said Section by the Supreme Court of the State of Washington in the case of State ex rel. Spokane v. Kuykendall, 119 Wash. 107.

IX

The court erred in holding that the alleged construction of said Section by the Supreme Court of the State of Washington was binding upon it and that it did not exercise its independent judgment in construcing said Section.

John H. Dunbar, Attorney General for The State of Washington; H. C. Brodie, Assistant Attorney General for the State of Washington, Attorneys for Appellants. J. M. Geraghty, Alex M. Winston, of Counsel.

[File endorsement omitted.]

[fol. 334] IN UNITED STATES DISTRICT COURT

[Title omitted]

PETITION FOR APPEAL—Filed August 17, 1926

The above named John C. Denney, as Director of Public Works of Washington, O. O. Calderhead, as Supervisor of Transportation of Washington, and C. Rea Moore, as Supervisor of Public Utilities of Washington, the persons constituting the Department of Public Works of the State of Washington, and John H. Dunbar, Attorney General of the State of Washington, feeling themselves aggrieved by the decree entered in the above entitled cause on the 18th day of May, 1926, granting a permanent injunction against these defendants, do hereby appeal from said decree to the Supreme Court of the United States and pray that this, their appeal, may be allowed and that a transcript of the record and proceedings in said cause and all things concerning the same upon which said decree was made, duly authenticated, may be sent to the Supreme Court of the United States in order that the errors complained of in the assignment of errors herein filed by the said defendants may be reviewed, and, if error be found, corrected according to the laws and customs of the United States.

[fol. 335] John H. Dunbar, Attorney General of the State of Washington; H. C. Brodie, Assistant Attorney General of the State of Washington, Solicitors for Defendants. J. M. Geraghty, Alex M. Winston, of Counsel.

[File endorsement omitted.]

[fol. 336] IN UNITED STATES DISTRICT COURT

[Title omitted]

ORDER ALLOWING APPEAL—Filed August 17, 1926

It is hereby ordered that the appeal prayed for by the above named defendants in the above entitled cause to the

Supreme Court of the United States be and same is hereby allowed as prayed.

Done in open court this 16 day of August, 1926.

Jeremiah Neterer, Judge.

[File endorsement omitted.]

[fol. 337] In United States District Court

[Title omitted]

Order Fixing Bond—Filed August 17, 1926

On reading the petition of the above named defendants in the above entitled cause for the allowance of an appeal to the Supreme Court of the United States from the decree rendered in said cause on May 18, 1926, granting a permanent injunction against the defendants, it is ordered that the defendants above named execute and file in the office of the clerk of the above entitled court a bond on appeal conditioned according to law in the sum of One Thousand Dollars ($1,000.00) with good and sufficient surety to be approved by the undersigned.

Done in open court this 16 day of August, 1926.

Jeremiah Neterer, Judge.

[File endorsement omitted.]

[fols. 338-340] Bond on appeal for $1,000 approved and filed August 17, 1926, omitted in printing.

[fols. 341-343] Citation, in usual form, showing service on O. B. Rupp et al., filed August 17, 1926, omitted in printing.

[fol. 344] In United States District Court

[Title omitted]

Præcipe for Transcript of Record—Filed August 17, 1926

To the clerk of the above entitled court:

Please make and certify on appeal to the Supreme Court of the United States, a record which includes the following files, to-wit:

1. Amended and supplemental complaint and Exhibits thereto attached.
2. Joint answer of defendants to amended and supplemental complaint with Exhibits thereto attached;
3. Report of John F. Condon, Special Master in Chancery;
4. Defendants' exceptions to Master's report;
5. Opinion of three judges filed April 22, 1926;
6. Decree of May 18, 1926;
7. Order of substitution;
8. Assignment of errors;
9. Petition for allowance of appeal;
10. Order allowing appeal;
11. Order fixing amount of bond on appeal;
12. Bond on appeal;
13. Citation;

[fol. 345] 14. Acceptance of service;

15. This præcipe and acknowledgment of service attached thereto.

Omit all captions except on amended and supplemental complaint.

John H. Dunbar, Attorney General of the State of Washington; H. C. Brodie, Assistant Attorney General of the State of Washington, Solicitors for Defendants.

Due regular and timely service of the foregoing præcipe is hereby acknowledged this 16th day of August, 1926.

Otto B. Rupp, Post & Russell, Pillsbury, Madison & Sutro, Solicitors for Plaintiff.

[File endorsement omitted.]

[fol. 346] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 347] In Supreme Court of the United States

Statement of Points to be Relied Upon and Designation by Appellants of Parts of Record to be Printed—Filed December 13, 1926

I

The appellants contend that a valid franchise contract now exists between the plaintiff and the City of Spokane, for the furnishing of residence and business telephonic service at maximum prices of less than the prices contained in the schedule filed by the plaintiff with the Department of Public Works and attached to the amended and supplemental complaint as Exhibit "A".

II

From the answer of the defendants to plaintiff's amended and supplemental complaint, it appears that in the year 1905 the plaintiff was granted a franchise by the City of Spokane for the erection, maintenance and operation of a telephone system for a period of thirty-five years and is now operating under said franchise. Under the terms thereof, the plaintiff agrees to furnish service, residence and business, at rates not to exceed a maximum in said franchise set forth, and such rates were less than the rates charged by plaintiff prior to the institution of this suit. It was determined by the Supreme Court of the State of Washington, that this franchise ordinance constituted a [fol. 348] valid contract between the plaintiff and the City of Spokane, subject to the power of the defendants and their predecessors in office to modify the terms thereof as to the maximum charges. The predecessors in office, of the defendants, on February 13, 1919, issued an order permitting the departure from said franchise rates and substituting other rates to be charged by the plaintiff.

It is the contention of the appellants that this order is void because of lack of jurisdiction on the part of the de-

fendants' predecessors in office, the telephone systems of the United States being then under the control of the government.

III

Another order was made by the defendants' predecessors in office on March 31st, 1923, this being the order under review herein. This order denied the plaintiff the right to a further raise in rates.

It is the contention of the appellants that in view of the fact that this order did not in any wise, change the existing rates, that plaintiff acquired no rights by the making thereof.

IV

Section 10379 of Remington's Compiled Statutes of the State of Washington, provides:

"Existing contracts—Effect.—Nothing in this act shall be construed to prevent any telegraph company or telephone company from continuing to furnish the use of its line, equipment or service under any contract or contracts in force at the date this act takes effect or upon the taking effect of any schedule or schedules of rates subsequently filed with the commission, as herein provided, at the rates fixed in such contract or contracts: provided, however, that the commission shall have power, in its discretion, to direct by order that such contract or contracts shall be terminated by the telephone company or telegraph company party thereto, and thereupon such contract or contracts shall be terminated by such telephone company or telegraph company as and when directed by such order."

[fol. 349] It is appellants' contention that when the statute says, that "thereupon such contract or contracts shall be terminated by such telephone company or telegraph company as and when directed by such order" that the true meaning thereof is that the defendants and their predecessors in office have the power and authority to modify the franchise contract in question and that by the orders in question, if effective at all, the contract was modified as directed, and as modified still exists.

V

The lower court held that such orders terminated the contract for all purposes, following an alleged construction of the statute of the Supreme Court of the State of Washington.

It is appellants' contention: First, that the Supreme Court of the State of Washington did not so hold; and, Second, that if it did so hold, that the question as to whether the contract still exists as modified is one upon which Federal Courts will exercise their independent judgment.

VI

Summarizing the foregoing statements, the sole question presented by this appeal is: Does a valid contract exist between the plaintiff and the City of Spokane for the furnishing of telephonic services? If so, no question of confiscation is presented and the Federal Courts are without jurisdiction.

For the consideration of the foregoing points appellants think that the following portions of the record are necessary and they, therefore, designate same to be printed:

1. Amended and supplemental complaint and exhibits thereto attached.

2. Joint answer of defendants to amended and supplemental complaint with exhibits thereto attached.

3. Of the report of John F. Condon, special master in chancery, only that portion with reference to "franchise contract as to rates" on pages 277 to 283, inclusive, of the [fols. 350 & 351] typewritten clerk's record.

4. Of the defendants' exceptions to the master's report, only exceptions Nos. 15, 19 and 20, at pages 286 and 289 of the clerk's typewritten record.

5. Opinion of three judges filed April 22, 1926.

6. Decree of May 18, 1926.

7. Order of substitution.

8. Assignment of errors.

9. Petition for allowance of appeal.

10. Order allowing appeal.

11. Order fixing amount of bond on appeal.

12. Bond on appeal.

13. Citation.

14. Acceptance of service.

15. Praecipe.

John H. Dunbar, Attorney General of the State of Washington; H. C. Brodie, Assistant Attorney General of the State of Washington, Solicitors for Appellant. J. W. Geraghty, Alex. M. Winston, of Counsel.

Service of the foregoing statement of points intended to be relied upon by appellant and designation of parts of the record to be printed acknowledged this 22nd day of September, 1926.

H. H. Rigg, Post & Russell, Pilcher, Hadley & Sutton, Solicitors for Appellee.

[Endorsed: No. 355] [File endorsement omitted.]

Endorsed on cover: File No. 32,136. W. Washington [illegible] T. S. Term No. 369. John F. Dunbar, as Director of Public Works of Washington, et al., Appellants, vs. Department of Transportation of Washington, et al. Filed December 15th, 1926. File No. 32,136.

IN THE

SUPREME COURT

OF THE

UNITED STATES

OCTOBER TERM, 1926.

No. 769.

JOHN C. DENNEY, as Director of Public Works of Washington; O. O. CALDERHEAD, as Supervisor of Transportation of Washington; and C. REA MOORE, as Supervisor of Public Utilities of Washington, the persons constituting the Department of Public Works of the State of Washington, and JOHN H. DUNBAR, Attorney General of the State of Washington,

Appellants,

v.

THE HOME TELEPHONE & TELEGRAPH COMPANY OF SPOKANE, a corporation,

Appellee.

APPEAL FROM A DECREE GRANTING A PERMANENT INJUNCTION.

Brief and Argument of Appellants

JOHN H. DUNBAR,
Attorney General of the State of Washington.

H. C. BRODIE,
Assistant Attorney General of the State of Washington.

J. M. GERAGHTY,
ALEX M. WINSTON,
Of Counsel.

Solicitors for Appellants.

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IN THE

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OCTOBER TERM, 1926.

No. 769.

JOHN C. DENNEY, as Director of Public Works of Washington; O. O. CALDERHEAD, as Supervisor of Transportation of Washington; and C. REA MOORE, as Supervisor of Public Utilities of Washington, the persons constituting the Department of Public Works of the State of Washington, and JOHN H. DUNBAR, Attorney General of the State of Washington,

Appellants.

v.

THE HOME TELEPHONE & TELEGRAPH COMPANY OF SPOKANE, a corporation,

Appellee.

APPEAL FROM A DECREE GRANTING A PERMANENT INJUNCTION.

Brief and Argument of Appellants

STATEMENT OF THE CASE.

The Appellee (hereinafter referred to as the "Company") is a corporation organized under the laws of the state of Washington. It is now engaged

in operating a general telephone and telegraph business in the city of Spokane, Washington, and the territory immediately adjacent thereto. The rates it charges for telephone service are subject to regulation by the Department of Public Works of the state, formerly the Public Service Commission. The Department of Public Works will be hereinafter referred to as the "Department." In 1905 the Company commenced its operations under a franchise fixing maximum rates for residence and business service and has ever since been and now is operating under said franchise (R. 23, 98, 100, 111).

On August 8, 1919, the Public Service Commission of Washington, on application of the Company, attempted to make an order prescribing the maximum rates to be thereafter charged by the Company for its service in the Spokane exchange and these rates were thereafter charged until September 20, 1922. On this latter date, the Company filed with the Commission a schedule advancing its rates over those charged by it since August 8, 1919 (R. 3, 18). Under the state law authorizing a suspension of rate increases, pending an investigation of their reasonableness (Remington's Compiled Statutes, 1922, sec. 10424), the Department on September 24, 1922, suspended the operation of the increased rates for the full statutory period (R. 3).

On March 31, 1923, the Department entered an order denying the Company's application to increase its rates (R. 33). On April 24, 1923, the Company

filed a complaint in the United States District Court for the Western District of Washington, Southern Division, and on May 21, 1925, the Company filed its amended and supplemental complaint in which it alleged the filing of the rate schedule of August 8, 1919, the filing of the rate schedule of September 20, 1922, the suspension of the latter schedule by the Department and the making by the Department of the order of March 31, 1923 (R. 1). The said complaint and amended complaint further alleged that by the refusal of the Department to permit the rate increase sought by the company, that it, the Company, was deprived of its property against the provisions of the Constitution of the United States and sought an injunction against the Department and the Attorney General restraining them from enforcing the order of March 31, 1923 (R. 7, 10-13). To this amended and supplemental complaint the Department and the Attorney General interposed an answer alleging, among other things, the existence of the franchise before mentioned, that the said franchise was still in force and effect, save as modified by the order of the Department of August 8, 1919, and that the rates charged by the Company under said last named order were in excess of the rates provided for in the franchise (R. 96-99).

This cause was referred to a Special Master who found that the franchise granted by the City of Spokane to the Company was still in effect, save for the action of the Department as evidenced by its orders

of August 8, 1919, and March 31, 1923 (R. 116). The Master then found that by the making of these orders the provisions of the franchise contracts, so far as rates are concerned, had been terminated and annulled by said orders and were no longer in effect (R. 118). This conclusion of the Master was adopted by the three-judge statutory court (*Pacific Tel. & Tel. Co. v. Whitcomb*, 12 Fed. 2d. 279) and an injunction granted against the Department and the Attorney General on the ground that the existing rates were confiscatory was made permanent (R. 129-138). From the decree, granting the permanent injunction, filed May 19, 1926, this appeal is taken (R. 139).

ASSIGNMENTS OF ERROR.

1. The lower court erred in granting the permanent injunction.

2. The lower court erred in holding that the order of the Department of August 8, 1919, annulled the franchise contract between the Company and the City of Spokane so far as rates are concerned.

3. The lower court erred in holding that the order of the Department of March 31, 1923, annulled the franchise contract so far as rates are concerned.

4. The lower court erred in not holding that the franchise contract between the Company and the City of Spokane is now in force and effect, save as modified by the orders of the Department, of dates August 8, 1919, and March 31, 1923.

ARGUMENT.

But one question is presented by this appeal, to-wit: Is the franchise contract between the Company and the City of Spokane in existence and in force and effect, save as altered and modified by the orders of the Department, or did the orders of the Department have the effect to annul the contract so far as the rates to be charged by the Company are concerned?

This franchise has been adjudicated, as to its terms concerning rates, to constitute a valid agreement between the Company on the one hand and the city and its citizens on the other, save as it might be altered by the Department or its predecessors.

> *State ex rel. Ellertsen v. Home Telephone and Telegraph Company*, 102 Wash. 196, 172 Pac. 899.

When the franchise to the Company was granted by the city, it was in legal effect granted by the state, acting through one of its political subdivisions, and is, therefore, in effect, a contract between the state and the Company, and, as is said by this court in *Henderson Water Co. v. Corporation Commission*, 269 U. S. 278, citing *Trenton v. New Jersey*, 262 U. S. 182:

> "Only by securing the waiver of the franchise rates by order of the Corporation Commission speaking for the state, would the Water Company have any standing to ask for a fixing of rates in excess of the franchise rates."

If, therefore, the contract as modified is still in existence, there is no confiscation of plaintiff's property and this court is without jurisdiction.

Columbus Ry. Power & Light Co. v. Columbus, 249 U. S. 399.

The order of the then Public Service Commission of Washington, entered on February 13, 1919, while in terms fixing new rates and directing the termination of the franchise contract, in so many words, was an order made by virtue of the statutory authority granted it. If it should be deemed, for the purpose of argument, that the Commission intended to wholly wipe out the contract and if it had no authority or jurisdiction so to do, the order is a nullity and may be collaterally attacked.

Schroeder v. Raymond, 117 Wash. 238, 204 Pac. 180.

When on February 13, 1919, the then Public Service Commission of Washington attempted to modify the exchange rates of the plaintiff, it was without jurisdiction so to do. The order was a nullity, the United States, through the Postmaster General, being in exclusive control of the operation of and the rates and charges of the Spokane exchange.

Dakota Central Tel. Co. v. So. Dak., 250 U. S. 163.

Section 10379 of Remington's Compiled Statutes of Washington is as follows:

"Nothing in this act shall be construed to prevent any telegraph company or telephone company

from continuing to furnish the use of its line, equipment or service under any contract or contracts in force at the date this act takes effect or upon the taking effect of any schedule or schedules of rates subsequently filed with the commission, as herein provided, at the rates fixed in such contract or contracts; *Provided, however*, That the commission shall have power, in its discretion, to direct by order that such contract or contracts shall be terminated by the telephone company or telegraph company thereto, and thereupon such contract or contracts shall be terminated by such telephone or telegraph company *as and when* directed by such order." (Italics, of course, ours.)

Other sections of the Code, numbered 10372, 10373, 10376, 10422, 10426 and 10428, show conclusively that it was the intention of the law-makers that all rates of public utilities should be under the control of the Commission or Department, as the case may be, and that a utility may only change an existing contract rate by the substitution of a rate fixed and approved by the Commission or Department, as the case may be.

In construing the quoted section, every word must be given effect and no single word having a meaning may be disregarded.

25 R. C. L. 1004;

Lawrence v. Allen, 7 Howard 785;

Bend v. Hoyt, 13 Peters 263.

Montclair Twp. v. Russell, 107 U. S. 147;

Postmaster Gen. of the U. S. v. Early, 12 Wheat. 136.

No effect can be given to the words "as and" unless the franchise contract still remains in existence, save as altered and modified by the order of the Commission or Department.

In the *Ellertsen* case, *supra*, it was said that the contract remained in existence "except as it may be relieved * * * by the operation of the Public Service Commission law." And, again, "assuming that by the act the state did give the Public Service Commission the right to modify the franchise rates."

In *State ex rel. Webster v. Superior Court King County*, 67 Wash. 37, 120 Pac. 861, it is said that the question there presented is whether the franchise rates "may be altered or annulled by the state under its reserved powers." Again, the state reserves the power to "alter, amend or annul the conditions of the franchise."

See also:

Monroe Water Co. v. Monroe, 135 Wash. 355, 237 Pac. 996, which last case quotes with approval from *State ex rel. Tacoma Ry. & Power Co. v. Public Service Commission*, 101 Wash. 601, at page 604, 172 Pac. 890 as follows:

"The first question is, whether the public service commission is authorized by the statute to relieve from the franchise provisions complained of when the income of the company is not sufficient to pay a reasonable rate upon the value of the property devoted to the public service and provide an adequate and sufficient service."

In *Arkansas Natural Gas Co. v. Arkansas Railroad Commission*, 261 U. S. 379, it is said:

"Indeed the exertion of legislative power solely to that end is precluded by the contract impairment clause of the constitution. The power does not exist *per se*. It is the intervention of the public interest which justifies and, at the same time, conditions its exercise."

See *Winfield v. Public Service Commission*, 118 N. E. 531.

The state has yielded a portion of its rights under the contract. A different rule might apply if it were attempted to impair a utility's rights.

Salem v. Salem Water, Light & Power Co., 255 Fed. 295.

The lower court based its ruling upon the franchise question upon *State ex rel. Spokane v. Kuykendall*, 119 Wash. 107, 205 Pac. 3. The writer of this brief was counsel in that case for the City of Spokane, and the only question there raised by him was that in view of the existence of the franchise contract, while the Department of Public Works had power to alter the terms of the franchise contract, it should exercise that power sparingly. The opinion only decides that an order fixing any rates to be charged is just as effective as if it directed that the rates provided in the franchise should be and are hereby terminated. With that conclusion we find no fault. The question, however, which we are raising here has never been squarely presented to the Supreme Court of the State of Washington and before federal courts will follow the ruling of state courts construing stat-

utes, the state courts' decisions thereon must be direct and positive.

25 C. J., 841;

Southern Ry. Co. v. Simpson, 131 Fed. 705.

This court is not bound by the decision in the *Kaykendall* case, even though it should deem it to be direct and positive. Where questions of contract rights and federal questions are involved, they should and must decide for themselves such questions, even though the construction and validity of state statutes are involved.

In *Pleasant Township v. Aetna Life Ins. Co.*, 138 U. S. 67, it is said:

"In matters of contract, especially, the right of citizens of different states to litigate in the federal courts of the various states is a right to demand the independent judgments of those courts."

In *Louisville Trust Co. v. City of Cincinnati*, 76 Fed. 296, Judge Lurton says, the present Chief Justice concurring:

"So where a question involved in the construction of a state statute practically affects those remedies of creditors which are protected by the constitution, courts of the United States will exercise an independent judgment as to the meaning of such statutes and will not be bound by the decisions of state courts, and this, whether the case arises upon a writ of error under the twenty-fifth section of the judiciary act, or is a case where the jurisdiction was dependent upon citizenship alone. So we think another well grounded exception exists where contracts and obligations have been entered upon before there has been any judicial construction of the statutes

upon which the contract or obligation depends by the highest court of the state whose statute is involved."

The facts in this case were: It was claimed on behalf of the appellant, the Louisville Trust Company, that appellee, the City of Cincinnati, had granted to the Cincinnati Inclined Plane Railway Company franchises over certain streets in the City of Cincinnati, which franchises were still in full force and effect. This claim was denied by the appellee and the appellee affirmatively showed that in an action brought by the city against the railway company it had been adjudged that the railway company had no valid franchise, and that the judgment of the lower court was affirmed by the Superior Court of Ohio in 52 Ohio State, 609, and that therefore the federal courts would follow the ruling of the Supreme Court of Ohio. This claim was denied by the Circuit Court of appeals, it using the language hereinbefore quoted. The *Louisville* case was cited with approval by this court in *Kuhn v. Fairmount Coal Co.*, 215 U. S. 349.

It is plain, therefore, from the foregoing that until the state, acting through the Department, gave some relief to the Company, the Company, like any individual, was bound by its contract and had no standing in the federal courts to claim confiscation of its property. It had sought the franchise from the City, upon terms fixed by it, and received it. Having

received the benefit of the franchise while it was profitable, it was bound to take the bitter with the sweet and abide by it, save as the state, acting through the Department, might, as a matter of grace, modify its terms. The Department did, with the consent of the city's attorneys, increase the rates to be charged about 50 per cent over the franchise rates. True, as hereinbefore shown, this order was void, but the City abided by it. When the second order was made on March 31, 1923, this order but denied the Company a further increase in rates.

It is evident that this is not a question of confiscation. It is a question of difference of opinion between the Department and the City on the one hand and the Company on the other as to what are fair rates to be charged. We believe, and the record in this case discloses, we have acted under that belief, that the Company is entitled to earn a fair return upon its investment. We are thoroughly in disaccord with the holding of this and inferior federal courts that, as we look at it, utilities are to be permitted to earn an excessive return upon a value fixed in substance on the cost of reproduction and adding thereto a mythical going value. For this reason we are asking of this court what we believe to be our rights under a valid and existing contract. We are firm in the belief that no injustice will be done the Company by such a holding by this court. We are not believers of baiting or ham-stringing utilities. Utilities must prosper if they are to give good service. They must

receive reasonable returns to so prosper and earn a fair rate upon the investment. The trouble in this case is not confiscation, but ingratitude on the part of the utility.

CONCLUSION.

If the words "AS AND WHEN" in the statute do not mean what we contend they mean, we invite counsel for appellee to say what they do mean.

For the foregoing reasons the judgment of the lower court should be reversed with instructions to dismiss the action.

Respectfully submitted,

JOHN H. DUNBAR,
Attorney General of the State of Washington,

H. C. BRODIE,
Assistant Attorney General of the State of Washington,
Solicitors for Appellants.

J. M. GERAGHTY,

ALEX M. WINSTON,
Of Counsel.

APPENDIX.

Section 10379 of Remington's Compiled Statutes 1922 of Washington.

Existing Contracts—Effect.

Nothing in this act shall be construed to prevent any telegraph company or telephone company from continuing to furnish the use of its line, equipment or service under any contract or contracts in force at the date this act takes effect or upon the taking effect of any schedule or schedules of rates subsequently filed with the commission, as herein provided, at the rates fixed in such contract or contracts: *Provided, however*, That the commission shall have power, in its discretion, to direct by order that such contract or contracts shall be terminated by the telephone company or telegraph company party thereto, and thereupon such contract or contracts shall be terminated by such telephone company or telegraph company as and when directed by such order.

Section 10372 of Remington's Compiled Statutes 1922 of Washington.

Tariff Schedule—Publication.

Every telephone and telegraph company shall file with the commission and shall print and keep open to public inspection at such points as the commission may designate, schedules showing the rates, tolls, rentals, contracts and charges of such companies for messages, conversations and services rendered and

equipment and facilities supplied for messages and services to be performed within the state between each point upon its line and all points upon every other similar line operated or controlled by it, and between each point on its line or upon any line leased, operated or controlled by it and all points upon the line of any other similar company, whenever a through service and joint rate shall have been established or ordered between any two such points. If no joint rate covering a through service has been established, the several companies in such through service shall file, print and keep open to public inspection as aforesaid the separately established rates, tolls, rentals, contracts and charges applicable for such through service. The schedules printed as aforesaid shall plainly state the places between which telephone or telegraph service, or both, will be rendered, and shall also state seperately all charges and all privileges or facilities granted or allowed, and any rules or regulations or forms of contract which may in any wise change, affect or determine any of the aggregate of the rates, tolls, rentals or charges for the service rendered. A schedule shall be plainly printed in large type and a copy thereof shall be kept by every telephone company and telegraph company readily accessible to and for convenient inspection by the public at such places as may be designated by the commission, which schedule shall state the rates charged from such station to every other station on such company's line, or on any line controlled and

used by it within the state. All or any of such schedules kept as aforesaid shall be immediately produced by such telephone company or telegraph company upon the demand of any person. A notice printed in bold type and stating that such schedules are on file and open to inspection by any person, the places where the same are kept and that the agent will assist such person to determine from such schedules any rate, toll, rental, rule or regulation which is in force shall be kept posted by every telephone company and telegraph company in a conspicuous place in every station or office of such company.

SECTION 10373 OF REMINGTON'S COMPILED STATUTES 1922 OF WASHINGTON.

Changes In Schedules.

Unless the commission otherwise orders, no change shall be made in any rate, toll, rental, contract or charge, which shall have been filed and published by any telephone or telegraph company in compliance with the requirements of the preceding section, except after thirty days' notice to the commission and publication for thirty days as required in the case of original schedules in the preceding section, which notice shall plainly state the changes proposed to be made in the schedule then in force, and the time when the changed rate, toll, contract or charge will go into effect, and all proposed changes shall be shown by printing, filing and publishing new schedules, or shall be plainly indicated upon the schedules in force at the time and kept open to public inspec-

tion. The commission for good cause shown may allow changes in rates, charges, tolls, rentals or contracts without requiring the thirty days' notice and publication herein provided for, by an order specifying the change so to be made and the time when it shall take effect, and the manner in which the same shall be filed and published. When any change is made in any rate, toll, contract, rental or charge, the effect of which is to increase any rate, toll, rental or charge then existing, attention shall be directed on the copy filed with the commission to such increase by some character immediately preceding or following the item in such schedule, which character shall be in such form as the commission may designate.

SECTION 10376 OF REMINGTON'S COMPILED STATUTES 1922 OF WASHINGTON.

Schedule Rate to Be Charged—Exceptions.

No telephone or telegraph company shall charge, demand, collect or receive different compensation for any service rendered or to be rendered than the charge applicable to such service as specified in its schedule on file and in effect at that time, nor shall any telephone company or telegraph company refund or remit, directly or indirectly, any portion of the rate or charge so specified, nor extend to any person or corporation any form of contract or agreement or any rule or regulation or any privilege or facility except such as are specified in its schedule filed and in effect at the time, and regularly and uniformly ex-

tended to all persons and corporations under like circumstances for like or substantially similar service.

No telephone company or telegraph company subject to the provisions of this act shall, directly or indirectly, give any free or reduced service or any free pass or frank for the transmission of messages by either telephone or telegraph between points within this state, except to its officers, employees, agents, pensioners, surgeons, physicians, attorneys at law, and their families and persons and corporations exclusively engaged in charitable and eleemosynary work, and ministers of religion, Young Men's Christian Associations, Young Women's Christian Associations; to indigent and destitute persons, and to officers and employees of other telephone companies, telegraph companies, railroad companies and street railroad companies.

SECTION 10422 OF REMINGTON'S COMPILED STATUTES 1922 OF WASHINGTON.

Complaints.

Complaint may be made by the commission of its own motion or by any person or corporation, chamber of commerce, board of trade, or any commercial, mercantile, agricultural or manufacturing society, or any body politic or municipal corporation, by petition or complaint in writing, setting forth any act or thing done or omitted to be done by any public service corporation in violation, or claimed to be in violation, of

any provision of law or of any order or rule of the commission: *Provided*, That no complaint shall be entertained by the commission except upon its own motion, as to the reasonableness of the schedule of the rates or charges of any gas company, electrical company, water company, or telephone company, unless the same be signed by the mayor, council or commission of the city or town in which the company complained of is engaged in business, or not less than twenty-five consumers or purchasers of such gas, electricity, water or telephone service: *Provided further*, That when two or more public service corporations, (meaning to exclude municipal and other public corporations) are engaged in competition in any locality or localities in the state, either may make complaint against the other or others that the rates, charges, rules, regulations or practices of such other or others with or in respect to which the complainant is in competition, are unreasonable, unremunerative, discriminatory, illegal, unfair or intending or tending to oppress the complainant, to stifle competition, or to create or encourage the creation of monopoly, and upon such complaint or upon complaint of the commission upon its own motion, the commission shall have power, after notice and hearing as in other cases, to, by its order, subject to appeal as in other cases, correct the abuse complained of by establishing such uniform rates, charges, rules, regulations or practices in lieu of those complained of, to be observed by all of such competing public service corporations in the

locality or localities specified as shall be found reasonable, remunerative, nondiscriminatory, legal, and fair or tending to prevent oppression or monopoly or to encourage competition, and upon any such hearing it shall be proper for the commission to take into consideration the rates, charges, rules, regulations and practices of the public service corporation or corporations complained of in any other locality or localities in the state.

All matters upon which complaint may be founded may be joined in one hearing, and no motion shall be entertained against a complaint for misjoinder of complaints or grievances or misjoinder of parties; and in any review of the courts of orders of the commission the same rules shall apply and pertain with regard to the joinder of complaints and parties as herein provided: *Provided*, All grievances to be inquired into shall be plainly set forth in the complaint. No complaint shall be dismissed because of the absence of direct damage to the complainant.

Upon the filing of a complaint, the commission shall cause a copy thereof to be served upon the person or corporation complained of, which shall be accompanied by a notice fixing the time when and place where a hearing will be had upon such complaint. The time fixed for such hearing shall not be less than ten days after the date of the service of such notice and complaint, excepting as herein provided. Rules of practice and procedure not otherwise provided for in this act may be prescribed by the commission.

SECTION 10426 OF REMINGTON'S COMPILED STATUTES 1922 OF WASHINGTON.

Remunerative Charges Cannot Be Changed.

Whenever the commission shall find, after hearing had upon its own motion or upon complaint as herein provided, that any rate, toll, rental or charge which has been the subject of complaint and inquiry is sufficiently remunerative to the public service company affected thereby, it may order that such rate, toll, rental or charge shall not be changed, altered, abrogated or discontinued, nor shall there be any change in the classification which will change or alter such rate, toll, rental or charge without first obtaining the consent of the commission authorizing such change to be made.

SECTION 10428 OF REMINGTON'S COMPILED STATUTES 1922 OF WASHINGTON.

Review.

Any complainant or any public service affected by any order of the commission, and deeming it to be contrary to law, may, within thirty days after the service of the order upon him, or it, apply to the superior court of the county in which such proceeding was instituted for a writ of review, for the purpose of having its reasonableness and lawfulness inquired into and determined. Such writ shall be made returnable not later than thirty days from and after the date of the issuance thereof, unless upon notice to all parties affected a further time be fixed by the

court, and shall direct the commission to certify its record in the case to the court. On such return day the cause shall be heard by the court, unless for good cause shown the same be continued. Said cause shall be heard by the court without the intervention of a jury on the evidence and exhibits introduced before the commission and certified to by it. Upon such hearing the superior court shall enter judgment either affirming or setting aside the order of the commission under review. In case said order is reversed by reason of the commission failing to receive testimoney properly proffered, the court shall remand the cause to the commission, with instructions to receive the testimony so proffered and rejected, and enter a new order based upon the evidence theretofore taken, and such as it is directed to receive. The court may, in its discretion, remand any cause which is reversed by it to the commission for further action.

IN THE

SUPREME COURT

OF THE

UNITED STATES

OCTOBER TERM, 1927

No. 161.

JOHN C. DENNY, as Director of Public Works of Washington, D. O. CLAUSEN, as Supervisor of Transportation of Washington, and O. RAY MAYER, as Supervisor of Public Utilities of Washington, the persons constituting the Department of Public Works of the State of Washington, and JOHN H. DUNBAR, Attorney General of the State of Washington,

Appellants,

vs.

THE HOME TELEPHONE AND TELEGRAPH COMPANY OF SPOKANE, a corporation,

Respondent.

APPEAL FROM A DECREE GRANTING A PERMANENT INJUNCTION.

REPLY BRIEF AND ARGUMENT OF APPELLANTS.

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IN THE

SUPREME COURT

OF THE

UNITED STATES

OCTOBER TERM, 1927

No. 151.

JOHN C. DENNEY, as Director of Public Works of Washington; O. O. CALDERHEAD, as Supervisor of Transportation of Washington; and C. REA MOORE, as Supervisor of Public Utilities of Washington, the persons constituting the Department of Public Works of the State of Washington, and JOHN H. DUNBAR, Attorney General of the State of Washington, *Appellants,*

vs.

THE HOME TELEPHONE AND TELEGRAPH COMPANY OF SPOKANE, a corporation, *Respondent.*

APPEAL FROM A DECREE GRANTING A PERMANENT INJUNCTION.

REPLY BRIEF AND ARGUMENT OF APPELLANTS

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IN THE

SUPREME COURT

OF THE

UNITED STATES

OCTOBER TERM, 1927

No. 151.

JOHN C. DENNEY, as Director of Public Works of Washington; O. O. CALDERHEAD, as Supervisor of Transportation of Washington; and C. REA MOORE, as Supervisor of Public Utilities of Washington, the persons constituting the Department of Public Works of the State of Washington, and JOHN H. DUNBAR, Attorney General of the State of Washington, *Appellants*,

vs.

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STATEMENT OF THE CASE.

We have read appellants' reply brief in the companion case brought by the appellants herein against the Pacific Telephone and Telegraph Company, a cor-

poration, respondent, and desire to add but little to it.

We desire, however, to correct statement in respondent's brief in this case, on page 10, as follows: "On August 8, 1919, the Public Service Commission (now the department) made an order continuing the Postmaster General's rates in effect." Counsel for respondent are in error in this, as this order was only made as to the rates of the Pacific Company. See quotation from the findings of the Master on page six of respondent's brief.

THE ORDER OF THE DEPARTMENT OF DATE MARCH 31, 1923, DID NOT AFFECT THE VALIDITY AND EXISTENCE OF THE FRANCHISE CONTRACT.

In discussing this question we contended in our opening brief that the true meaning of section 10379 of Remington's Compiled Statutes of Washington is that when an order is made by the Department of Public Works directing the termination of a franchise contract and fixing new rates in such order, the franchise contract still remains in force, save as modified by the department's order.

At the close of our opening brief, under the head "Conclusion" we said: "If the words 'as and when' in the statute do not mean what we contend they mean, we invite counsel for respondent to say what they do mean." This courteous invitation was declined by the learned counsel for respondent. Because of such failure we think we are entitled to say

to the court that counsel for respondent concedes that the true meaning of the statute is what we say it means.

The Commission Act should be read as a whole. Section 10391 of the code, under which the order of the department of date March 31, 1923, was made, is as follows:

"Whenever the commission shall find, after a hearing had upon its own motion or upon complaint, that the rates, charges, tolls or rentals demanded, exacted, charged or collected by any telegraph company or telephone company for the transmission of messages by telegraph or telephone, or for the rental or use of any telegraph line, telephone line or any telegraph instrument, wire, appliance, apparatus, or device or any telephone receiver, transmitter, instrument, wire, cable, apparatus, conduit, machine, appliance or device, or any telephone extension or extension system, or that the rules, regulations or practices of any telegraph company or telephone company affecting such rates, charges, tolls, rentals or service are unjust, unreasonable, unjustly discriminatory or unduly preferential, or in anywise in violation of law, or that such rates, charges, tolls or rentals are insufficient to yield reasonable compensation for the service rendered, the commission shall determine the just and reasonable rates, charges, tolls or rentals to be thereafter observed and in force, and fix the same by order as hereinafter provided.

"Whenever the commission shall find, after such hearing that the rules, regulations or practices of any telephone company or telegraph company are unjust or unreasonable, or that the equipment, facilities or service of any telegraph company or telephone company is inadequate, inefficient, improper or insufficient, the commission shall determine the just, reasonable, proper, adequate and efficient rules, regula-

tions, practices, equipment, facilities and service to be thereafter installed, observed and used, and fix the same by order or rule as hereinafter provided."

Under the statutes conferring power upon the department, it sits judicially and can only act within the scope of the statutes. 15 R. C. L., p. 841.

In *Schroeder v. Raymond*, 117 Wash. 238, 200 Pac. 1092 a like question was presented. One of the appellants, Coshun, brought an action against the City of Raymond and others to foreclose the lien of certificates of delinquency for general taxes. The land was in the City of Raymond and there were upon the property in question certain unpaid local improvement assessments. The City of Raymond was served with process and did not appear. A judgment was rendered in the action foreclosing the lien of the certificates of delinquency as against all of the defendants. Thereafter, the holders of bonds for the special improvements brought an action to foreclose the lien of such bonds. Defense was made on the ground that the City of Raymond, having been a party to the former proceeding, was barred by the general judgment in that case. The lower court held that under the provisions of Remington's Code, section 7892-40, which reads:

"The holder of any certificate of delinquency for general taxes shall, before commencing any action to foreclose the lien of such certificate pay in full all local assessments or installments thereof outstanding against the whole or any portion of the property included in such certificate of delinquency, or, he may elect to proceed to acquire title to such property sub-

ject to certain or all local assessments a lien thereon, in which case the complaint, decree of foreclosure, order of sale, sale, certificate of sale and deed shall so state."

The Supreme Court of the State of Washington, in affirming the judgment of the lower court, said:

"Not having paid the local assessments, appellants must be held to have elected to take title thereto. The court having the power to grant only the statutory relief, the language of the statute must be read into the decree, and such being the effect of the judgment appealed from, that judgment must be and is affirmed."

It will be noted in section 10391 of the code that if the department finds "that such rates, charges, tolls or rentals are insufficient to yield reasonable compensation for the services rendered, the commission shall determine the just and reasonable rates, charges, tolls or rentals to be thereafter observed and in force, and fix the same by order as hereinafter provided."

The department's jurisdiction in the case at bar, in substance, was, after a hearing, to find whether the rates charged were insufficient to yield reasonable revenue. If it had found that the rates were so insufficient, it was its duty to determine the new rates which were to be charged. The department did not make such a finding. On the contrary, it having found that the rates and charges were reasonable, it had no jurisdiction to make an order prescribing other rates to be thereafter charged.

The most casual reading of the section in question does not give the department any jurisdiction to make an order in reference to existing rates unless the order changes in some manner such existing rates.

It, therefore, follows that anything in the order of March 31, 1923, beyond the denying of the increase asked for by the respondent, is of no effect.

The action of the department in this matter was a negative one and not an affirmative one, as contemplated by the law, and the respondent can not gain any advantage by it. The order stands upon the same basis as that of a judgment of the court denying relief to a litigant. Surely in such a case a litigant could attain no right by an adverse judgment.

The case of *State ex rel. Spokane v. Kuykendall*, 119 Wash. 107, 205 Pac. 3, is readily distinguishable from the case at bar, as in the *Kuykendall* case an order was made permitting an increase of rates to be charged by the utility.

THE APPELLANTS ARE ENTITLED TO A DETERMINATION BY THIS COURT OF THE QUESTION PRESENTED BY THEIR APPEAL.

It is urged on pages 23 and 24 of respondent's brief that the department of public works will not be heard to controvert the construction of a state statute and a rule of public policy announced by the court of last resort of the state of Washington. We understand the rule so laid down in *Stewart v. Kansas City*, 239 U. S. 14, and the cases cited therein

and other cases, to be that a state officer may not challenge in the United States Supreme Court the decision of his state court construing a state statute, and we have no quarrel here with that rule. We do contend, however, that the rule has no applicability in this case. The *Stewart* case and practically all the cases of similar character are cases where the state officer by writ of error is making a direct attack upon the state court's decision, and asking the Supreme Court to reverse that very decision. In the instant case the appellants have been deprived of any opportunity to present the question to the state court, because the respondent has preferred to litigate the matters in this controversy in the Federal court.

It was stated on page 14 of our opening brief that the opinion of the state court in *State ex rel. Spokane v. Kuykendall*, 119 Wash. 107, only decides that an order of the department fixing rates to be charged by a public service company, which order did not make specific reference to the franchise rate, nevertheless terminated the franchise rate just as effectively as if stated in express terms that the rates provided in the franchise are hereby terminated. It was further stated in our opening brief that the question which we are raising here has never been squarely presented to the supreme court of the state of Washington. In other words, the supreme court of Washington has decided that, when the department makes an order authorizing a rate different from the franchise rate, it thereby terminates the

franchise *rate*. Our court, however, has never been asked to determine the question which we present in this case, namely, that, when the department has terminated a franchise rate, the effect is to substitute for the terminated rate the new rate prescribed by the department, and the franchise continues as a binding contract between the company and the city, being merely altered or modified as to the rate. It is the contention of respondent that, when the department terminates a franchise rate, there is no longer any franchise rate provision, but the rate becomes a statutory rate and is thereafter governed by the general statutory provisions. It is the contention of appellants that, when the department terminates a franchise rate and prescribes a new rate, the effect of the department's order is simply to terminate one rate and substitute therefor a new rate, and that, after such substitution has been made, there still continues a franchise contract between the company and the city, which cannot be again changed except by the discretion of the department, and that the refusal of the department to exercise that discretion raises no question of confiscation. We think it clearly apparent that this question, which we now urge, has never been presented to the state court, and that we may now properly present it to this court in the first instance, the respondent, having by choice of the Federal forum, rendered it impossible to present it to the state court. Since the question involved in this litigation has never been presented to the state court, obviously the

department's appeal from the district court does not constitute an attack upon the state court's interpretation of a state statute.

We are of the opinion that the judgment of the lower court was erroneous and should be reversed with instructions to dismiss the action.

Respectfully submitted,

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Solicitors for Appellants.

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In the

Supreme Court of the United States

OCTOBER TERM, 1927

No. 151

JOHN C. DENNEY, as Director of Public Works of Washington; O. O. CALDERHEAD, as Supervisor of Transportation of Washington; and C. REA MOORE, as Supervisor of Public Utilities of Washington, the persons constituting the Department of Public Works of the State of Washington, and JOHN H. DUNBAR, Attorney General of the State of Washington,

Appellants,

vs.

THE HOME TELEPHONE AND TELEGRAPH COMPANY OF SPOKANE, a corporation,

Respondent.

APPEAL FROM THE DECREE OF THE DISTRICT COURT OF THE UNITED STATES, FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION

Brief of Respondent

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APPEAL FROM THE DECREE OF THE DISTRICT COURT OF THE UNITED STATES, FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION

Brief of Respondent

STATEMENT OF THE CASE

The Department of Public Works of the State of Washington (the members of which and the Attorney General are the appellants, and are hereinafter re-

ferred to as the "Department") after an exhaustive investigation in which all parties in interest were fully heard, entered the order in suit on March 31, 1923, prescribing the telephone rates to be charged by The Home Telephone and Telegraph Company of Spokane, appellee (hereinafter referred to as the "Company") in the Spokane Exchange.

A few days later this suit was commenced by the Company in the District Court of the United States, for the Western District of Washington, to enjoin the enforcement of these rates as being confiscatory of the property of the Company in violation of the due process provision of the Fourteenth Amendment.

An interlocutory injunction was applied for and granted by the three-judge court constituted under Section 266 of the Judicial Code, and thereafter the cause was heard by a Special Master upon whose report the court of three judges (organized pursuant to Section 266 as amended February 13, 1925, requiring three judges on final hearing) entered its final decree adjudging the rates confiscatory and granting a permanent injunction.

The case below is *Home Tel. & Tel. Co. of Spokane v. Denney, et al.*, 12 Fed. (2d) 279. The opinion is in the Record, pp. 120-139.

The defense below presented two principal contentions, namely: first, that the rates were not confiscatory in effect, and, second, that the rates to be charged in Spokane were contractual franchise rates, and therefore were not confiscatory in the constitutional sense, although non-compensatory.

The first contention has now been abandoned, and it stands admitted that the rates were confiscatory in effect. Only the second question is, therefore, presented upon this appeal. In deciding this question in favor of the Company, the court below said:

"In behalf of the cities of Seattle, Tacoma* and Spokane, it is contended that the plaintiff companies are entitled to no relief because in these cities the companies were operating under franchises which prescribed rates substantially lower than those allowed by the department, and that the franchise rates are controlling, particularly since the department did not expressly and in pointed terms abrogate and cancel them. It cannot be doubted that where a franchise contract is entered into between a municipality and a public utility corporation fixing rates to be charged by the latter for a not grossly unreasonable period of time, such rates are binding and enforcible, even those confiscatory of the property involved. *St. Cloud Public Service Co. v. City of St. Cloud*, 44 S. Ct. 492, 265

*The reference to Seattle and Tacoma is due to the fact that the case of Pacific Tel. & Tel. Co. against the Department (which involved Seattle and Tacoma rates) and this case, were considered as consolidated for certain purposes by the Special Master and the Statutory Court.

U. S. 352, 68 L. Ed. 1050. Nor can it be doubted that under the statutes of the state of Washington the department has the power to abrogate and cancel such franchise rates if in a proper case it sees fit to do so. Section 10379 of Remington's Compiled Statutes of Washington provides:

" 'Nothing in this act shall be construed to prevent any telegraph company or telephone company from continuing to furnish the use of its line, equipment, or service under any contract or contracts in force at the date this act takes effect or upon the taking effect of any schedule or schedules of rates subsequently filed with the commission, as herein provided, at the rates fixed in such contract or contracts: Provided, however, that the commisssion shall have power, in its discretion, to direct by order that such contract or contracts shall be terminated by the telephone company or telegraph company party thereto, and thereupon such contract or contracts shall be terminated by such telephone company or telegraph company as and when directed by such order. L. 1911, p. 567, §43.'

"Construing this statute in the case of *State ex rel. Spokane v. Kuykendall*, 205 P. 3, 4, 5, 119 Wash. 107, 111, 112, the Supreme Court of Washington said:

" 'By the act of 1911 (Laws of 1911, p. 551, § 34) the terms of a franchise contract like the one in question here are binding upon the parties until the Department of Public Works (heretofore the Public Service Commission) has made an order directing a departure therefrom; and, without question, the department has the right and power to order a departure. *State ex rel. Ellertsen v. Home Tel. &*

Tel. Co., 172 P. 899, 102 Wash. 196. In the case of *State ex rel. Webster v. Superior Court*, 120 P. 861, 67 Wash. 37, L. R. A. 1915C, 287, Ann. Cas. 1913D, 78, it was decided that the Public Service Commission law places the entire subject of rate regulation under the control of the commission, that no contract between a city representating the public and a public service company would be allowed to interfere with that control, and by way of application of the rule, it was decided in that case to be the duty of the commission to the company to fix a rate which was sufficient (a rate that would afford a fair interest return on the investment), in spite of the franchise contract fixing rates which were too low. That, in legal effect, is what has been done in the present case.'

"In this same case the point was urged that the department, in fixing the new rates, did not in express terms cancel and terminate the franchise rates. Answering this contention, the court said:

" 'The present order of the Department of Public Works is just as effective as if, after fixing the rates, there had been added therein the words, "and it is hereby directed that the rates provided in the franchise shall be and they are hereby terminated," or words of similar import. That is the legal effect of what was done, and the form or language by which it was accomplished is not very material.'

"This holding is the construction of a state statute by the court of last resort of the state, and consequently is binding upon this court. The special master concluded that the order of the Public Service Commission (now the Department of Public Works) entered on August 8, 1919, and after the termination

of federal control of the properties, continuing in effect the rates established by the Postmaster General so far as the Pacific Company is concerned, and the orders of the department to the same effect entered on March 31, 1923, as to both the Pacific and the Home Companies, had the effect of terminating and abrogating the franchise rates, and that the rates established by the department in their stead became 'department' or 'statutory' rates, as distinguished from 'franchise' or 'contract' rates. In this we agree with him. *State ex rel. Spokane v. Kuykendall, supra.* It may be conceded that the department was not obliged to grant any relief against the rates stipulated in the franchises, and that it could not by judicial action be compelled to do so. Yet, if it undertakes to terminate such rates pursuant to its plain statutory powers, the rates substituted instead must be fair, just, and reasonable, if the plain mandate of the statute defining its duties is to be obeyed. And, when the substituted rates are challenged, they must be considered as statutory—not franchise—rates, and their character as being confiscatory or not must be measured by the principles of law applicable to such rates."

(12 Fed. (2d) 287, 288; R. pp. 189, 190, 191.)

We might well rest the Company's case upon the foregoing opinion.

POINTS AND AUTHORITIES

When the Department by order prescribes telephone rates, the rate provisions of numerous franchises are *ipso facto* terminated and the rates so fixed by order of the Department, become department, or statutory, rates as distinguished from franchise or contract rates, and their character as being confiscatory or not must be tested by the general and familiar principles of law applicable to rate regulation. If such rates are confiscatory in their effect, they are void.

(a) The Supreme Court of the State of Washington has definitely so held.

State ex rel. Spokane v. Kuykendall, 119 Wash. 107.

See also—

State ex rel. Webster v. Superior Court, 67 Wash. 37;

Puget Sound Traction Co. v. Reynolds, 244 U. S. 574-9.

(b) This construction of the state statute by the highest court of the State is binding upon the Federal courts.

Claiborne County v. Brooks, 111 U. S. 400;

Norton v. Shelby County, 118 U. S. 425;

Williams v. Eggleston, 170 U. S. 304;

Hunter v. Pittsburgh, 207 U. S. 161;

Old Colony Trust Co. v. Omaha, 230 U. S. 100;

Pacific Livestock Co. v. Oregon Water Board, 241 U. S. 440;

Pennsylvania R. R. Co. v. Towers, 245 U. S. 6;

New York & Queens Gas Co. v. McCall, 245 U. S. 345;

Pawhuska v. Pawhuska Oil & Gas Co., 250 U. S. 394;

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Southern Iowa Electric Co. v. Chariton, 255 U. S. 539;

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Georgia Ry. & P. Co. v. Decatur, 262 U. S. 432;

Opelika v. Opelika Sewer Co., 265 U. S. 215;

Old Colony Trust Co. v. Tacoma, 230 Fed. 389.

The cases cited and relied upon in appellants' brief as supporting the contrary rule are not in point.

Moreover, even in a case in which the Federal courts may exercise an independent judgment, the settled rule is that any reasonable doubt will be resolved in favor of that construction of a state statute

which has been adopted by the court of last resort in the state. In this case, the state rule is sound.

Yazoo & Mississippi Valley R. R. Co. v. Adams, 181 U. S. 580;

Burgess v. Seligman, 107 U. S. 20;

Barnum v. Okolona, 148 U. S. 393;

Kuhn v. Fairmont Coal Co., 215 U. S. 349;

Sim v. Edenborn, 242 U. S. 131.

(c) The Department will not be heard to controvert the construction of a state statute and a rule of public policy announced by the court of last resort of the state.

Southern Iowa Electric Co. v. Chariton, 255 U. S. 539;

Stewart v. Kansas City, 239 U. S. 14.

ARGUMENT

The Company's franchise to operate in the City of Spokane was granted under Ordinance A-21118, passed by the City Council on August 18, 1905, after its submission to and adoption by a vote of the people of the City of Spokane (R. pp. 100-10). The ordinance named maximum telephone rates, and the rates prescribed by the Department, which are in

controversy in this case, are in excess of the ordinance rates.

On August 1, 1918, the Postmaster General, under the authority of Congress, took possession of the telephone lines of The Home Telephone and Telegraph Company of Spokane, and retained control until August 1, 1919. During the period of Federal control, telephone rates were materially increased by the Postmaster General in the City of Spokane. The Public Service Commission of Washington on March 20, 1919, during the period of Federal control, made an order establishing the rates fixed by the Postmaster General as the rates of The Home Telephone and Telegraph Company of Spokane (R. p. 116). At the expiration of the period of Federal control, Congress provided that the rates theretofore fixed by the Postmaster General should continue in effect for a period of four months unless an application was made to the State Commission, or other regulatory body, for other rates. On August 8, 1919, the Public Service Commission, now the Department made an order continuing the Postmaster General's rates in effect (R. p. 116).

The Department thereafter filed a formal complaint on January 21, 1922, challenging the rates of the Home Company, and entered upon an exhaustive

investigation to which all interested persons were made parties, including the City of Spokane (R. p. 34).

After a number of hearings, in which witnesses were heard and full opportunity given for cross-examination, the Department made the order in suit, by which the Company's property was valued and existing rates continued in effect. In its investigation leading up to the order in suit, it is clear that the Department proceeded upon the theory that the franchise rates had no force and effect, and that it was in no way hampered thereby.

WHEN THE DEPARTMENT BY ORDER PRESCRIBES TELEPHONE RATES, THE RATE PROVISIONS OF MUNICIPAL FRANCHISES ARE IPSO FACTO TERMINATED AND THE RATES SO FIXED BY ORDER OF THE DEPARTMENT BECOME DEPARTMENT OR STATUTORY RATES AS DISTINGUISHED FROM FRANCHISE OR CONTRACT RATES, AND THEIR CHARACTER AS BEING CONFISCATORY OR NOT MUST BE TESTED BY THE GENERAL AND FAMILIAR PRINCIPLES OF LAW APPLICABLE TO RATE REGULATION. IF SUCH RATES ARE CONFISCATORY IN THEIR EFFECT THEY ARE VOID.

THE SUPREME COURT OF THE STATE OF WASHINGTON HAS DEFINITELY SO HELD

In the case of *State ex rel. Webster v. Superior Court*, 67 Wash. 37, it was contended by the City of

Seattle that the rate provision in the franchise granted to the Independent Telephone Company could not be abrogated or terminated by the regulatory body of the state. The Supreme Court, in answer to that contention, said:

"It having been heretofore held that the constitutional power can be exercised through a commission with power to fix rates, and that the public is not bound to pass a general law fixing maximum rates, it follows that the public utilities act is a 'general law,' and under many decisions of this court, supersedes any ordinance or charter provision of any city which may conflict therewith. The power to fix rates is a mere detail in the execution of the general law, and cannot be insisted upon as the essential letter of the law."

And again—

"Where the state is a party, and it appears that there has been no express grant or waiver of its constitutional right to fix rates so as to give an ordinance the force of a contract binding upon the state (granting that under our constitution this could be done), it cannot be held, as a matter of either law or policy, that a franchise such as the one now under consideration is a contract binding upon the State of Washington."

These principles have been reaffirmed many times by the Supreme Court of the State of Washington, but we think we need not quote from the decisions

so holding because this court itself, in the case of *Puget Sound Traction Co. v. Reynolds*, 244 U. S. 574, has clearly and succinctly stated the position of the Washington Supreme Court. In the case just mentioned it is said:

"Assuming (what is not clear) that the provision in the franchise ordinances respecting the rates of fare and the transfer privilege are contractual in form, still it is well settled that a municipality cannot, by a contract of this nature, foreclose the exercise of the police power of the State unless clearly authorized to do so by the supreme legislative power. The Constitution of Washington, Art. XII, § 18, requires the Legislature to pass laws establishing reasonable maximum rates of charges for the transportation of passengers and freight, and to correct abuses and prevent discrimination in rates by railroads and other common carriers, and provides that, 'A railroad and transportation commission may be established, and its powers and duties fully defined by law.' By Art. XI, § 10, any city containing a population of twenty thousand inhabitants or more is permitted to frame a charter for its own government 'consistent with and subject to the constitution and laws of this state.' This constitution was adopted in 1889, long previous to the date of the earliest of plaintiff's franchise ordinances. The Supreme Court of Washington has held that the provisions of municipal charters are subject to the legislative authority of the State; that the Public Utilities Act superseded any conflicting ordinance or charter provisions of any city; and that contractual provisions in franchises conferred by mu-

nicipal corporations without express legislative authority are subject to be set aside by the exercise of the sovereign power of the State."

A more precise and exact announcement will be found in the case of *State ex rel. Spokane v. Kuykendall*, 119 Wash. 107, where the court, after stating the statutory provision here involved, said:

"Therefrom it appears to be argued that the rates provided in the contract should continue until the commission makes an order specifically declaring and directing in so many words that the contract shall be terminated. We may overlook the fact, if need be, that, upon the petition of the city, the rates were reduced in 1913, and that in 1918 they were increased upon the application of the gas company, and consider the franchise contract as having been wholly undisturbed until the present time, and still we would be compelled to determine, as we do determine, that the present order of the Department of Public Works is just as effective as if, after fixing the rates, there had been added therein the words 'and it is hereby directed that the rates provided in the franchise shall be and they are hereby terminated,' or words of similar import. That is the legal effect of what was done, and the form or language by which it was accomplished is not very material."

THIS CONSTRUCTION OF THE STATE STATUTE BY THE COURT OF LAST RESORT OF THE STATE IS BINDING UPON THE FEDERAL COURTS.

In *Norton v. Shelby County*, 118 U. S. 425, 439, this court said:

"Upon the construction of the constitution and laws of a state, this court, as a general rule, follows the decisions of her highest court, unless they conflict with or impair the efficacy of some principle of the Federal Constitution, or of a Federal statute, or a rule of commercial or general law. In these cases no principle of the Federal Constitution, or of any Federal law, is invaded, and no rule of general or commercial law is disregarded. The determination made relates to the existence of an inferior tribunal of the state, and that depending upon the constitutional power of the legislature of the state to create it and supersede a pre-existing institution. Upon a subject of this nature the Federal courts will recognize as authoritative the decision of the state court. As said by Mr. Justice Bradley, speaking for the court in Claiborne County v. Brooks, 111 U. S. 400, 410: 'It is undoubtedly a question of local policy with each state what shall be the extent and character of the powers which its various political and municipal organizations shall possess; and the settled decisions of its highest courts on this subject will be regarded as authoritative by the courts of the United States; for it is a question that relates to the internal constitution of the body politic of the state'."

In *Pennsylvania R. R. Co. v. Towers*, 245 U. S. 6, Mr. Justice Day, speaking for this court, said:

"The Court of Appeals of Maryland stated the question to be whether it is within the power of the Public Service Commission to require the establishment of a schedule of commutation rates by the railroad company, not where no such rates had theretofore been established, but where a new system of commutation rates had been proposed by the railroad company and submitted to the commission. Whether commutation rates should be established was declared to be a question of policy to be decided by the company. The court found authority in the commission under the statutes of Maryland to revise commutation rates where such rates had already been established by the action of the company. We must accept this definition of authority in the commission, so far as the state law is concerned, and direct our inquiry to the federal question presented."

In *Pawhuska v. Pawhuska Oil Co.*, 250 U. S. 394, the court said:

"It is not contended—nor could it well be—that any private right of the city was infringed, but only that a power to regulate in the public interest theretofore confided to it was taken away and lodged in another agency of the state—one created by the state constitution. Thus the whole controversy is as to which of two existing agencies or arms of the state government is authorized for the time being to exercise in the public interest a particular power, obviously governmental, subject to which the franchise confessedly

was granted. In this no question under the contract clause of the Constitution of the United States is involved, but only a question of local law, the decision of which by the Supreme Court of the state is final."

In *Douglas v. Noble*, 261 U. S. 165, there came before this court for consideration the dental law of the State of Washington. Mr. Justice Brandeis, speaking for this court, said that the construction of that statute

"• • • is a question of state law. Since the case is here on appeal from a Federal court, we must consider it, *Davis v. Wallace*, 257 U. S. 478. But in passing upon such questions we follow applicable decisions of the highest court of the state."

Again, in *Georgia Railway Co. v. Decatur*, 262 U. S. 432, 437, the court said:

"The principal question, and the one to which the briefs and arguments are mainly directed, is, whether the agreement between the plaintiff and the Electric Company was within the powers of the town and is now valid and subsisting. This contract has been before the Supreme Court of Georgia in the course of the litigation on three distinct occasions: 149 Ga. 1; 152 Ga. 143, and (the instant case) 153 Ga. 329. That court, in carefully considered and well reasoned opinions, sustained the authority of the municipality and upheld the contract as valid and subsisting. Defendants contend that the authority to fix rates devolved by the state constitution upon the General As-

sembly, and, therefore, that the Town of Decatur was without power to enter into a contract on that subject. When the contract was made the General Assembly had never exercised this authority and the state Supreme Court held that there was nothing in the constitution of the state which precluded the municipality from contracting as to fares; and that, while the matter was one falling within the police power, whose exercise could not be abridged by contract, it was competent for the municipality to enter into such a contract where the state had not exercised and was not seeking to exercise its police power over the subject, and that this contract would remain effective until there should be conflicting legislative action. See *Milwaukee Electric Ry. Co. v. Wisconsin R. R. Comm.*, 238 U. S. 174, 183. This conclusion, involving, as it does, a construction of the state constitution and laws and powers of state municipalities, is controlling upon this court, as it has decided many times."

Finally, in the case of *Southern Iowa Electric Co. v. Chariton*, 255 U. S. 539, it appears that three different public utilities operating in three municipalities in the State of Iowa brought suits to enjoin the enforcement of maximum rates concededly confiscatory, but specified in the franchises granted by the municipalities to the companies. The municipalities contended that they had the power to make a binding contract as to rates. The Supreme Court of Iowa had held that in that state there could not be a valid contract fixing

ermanent rates. Nevertheless, the trial judge dis-
issed the bills of complaint filed on behalf of the
tilities. On appeal this court reversed the action of
ne court below, saying:

"The total want of power of the municipalities here
n question to contract for rates, which is thus estab-
shed, and the state public policy upon which the pro-
ibition against the existence of such authority rests,
bsolutely exclude the existence of the right to en-
orce, as the result of the obligation of a contract, the
oncededly confiscatory rates which are involved, and
herefore conclusively demonstrate the error com-
nitted below in enforcing such rates upon the theory
f the existence of contract. And, indeed, the neces-
ity for this conclusion becomes doubly manifest when
t is borne in mind that the right here asserted to con-
ract in derogation of the state law and of the rule
f public policy announced by the court of last resort
f the state is urged by municipal corporations whose
very power depends upon the state law."

See also—

Claiborne County v. Brooks, 111 U. S. 400;

Williams v. Eggleston, 170 U. S. 304;

Hunter v. Pittsburgh, 207 U. S. 161;

Old Colony Trust Co. v. Omaha, 230 U. S. 100;

Pacific Livestock Co. v. Oregon Water Board, 241 U. S. 440;

New York & Queens Gas Co. v. McCall, 245 U. S. 345;

Maguire v. Reardon, 255 U. S. 271;

Opelika v. Opelika Sewer Co., 265 U. S. 215;

Old Colony Trust Co. v. Tacoma, 230 Fed. 389.

Now, how does the Department attempt to avoid the application of the rule stated in the foregoing cases? It asserts that this case falls within an alleged exception to the rule we invoke, and the cases of *Pleasant Township v. Aetna Life Ins. Co.*, 138 U. S. 67, and *Louisville Trust Co. v. City of Cincinnati*, 76 Fed. 296, are relied upon as sustaining that contention. But both of the cases cited involve private contract rights which had accrued prior to the decisions of the state courts. Neither of these cases involved the construction of a statute whereby the governmental power to regulate, subject to which a franchise had been granted, was taken away from a municipality and vested in another agency of the state.

Neither of the cited cases is, therefore, in point.

But if we view this cause from a somewhat different angle, nevertheless the same conclusion must follow.

We readily agree that when, under the Washington law, a public utility makes an application for rates in excess of those specified in a franchise, the regula-

tory body of that State is not compelled to act on that application. But if it does act, what is its duty? Practically the whole purpose of regulation is to secure adequate service, and to approve or fix fair rates. It will not be questioned, however, that a fair rate is one which is just, reasonable and sufficient, and that a rate confiscatory in effect is neither just, reasonable nor sufficient.

But if the regulatory body does not have the power to "terminate"—put an end to—rates which are unjust, unreasonable and insufficient, even though such rates are specified in a franchise, how can the purpose of regulation be accomplished?

The construction, therefore, placed upon the statute by the Washington Supreme Court, that it was "the duty of the Commission to the Company to fix a rate which was sufficient" (119 Wash. at p. 112), and that an order establishing rates at variance with franchise rates, terminated such franchise rates, is not only a reasonable, but also a sound construction of the statute.

Now, even in a case in which the Federal courts may exercise an independent judgment, the settled rule is that any reasonable doubt will be resolved in favor of that construction of a state statute which has been adopted by the court of last resort in the state.

In *Yazoo & Mississippi Val. R'd. Co. v. Adams*, 181 U. S. 580, 582, it is said:

"The statutes of the State of Mississippi necessary to be considered for the purpose of ascertaining whether the taxes for the year 1892 accrued prior to October 24 of that year, are complex and difficult of interpretation. Assuming that we may exercise an independent judgment respecting their construction, the examination we have given them leaves us in great doubt whether the argument that the taxes had accrued prior to the consolidation is a sound one. The right asserted depends upon a comparison and construction of such statutes and the settled rule of this court is that, even in a case where we may exercise an independent judgment, any reasonable doubt will be resolved in favor of that construction of the state statute which has been adopted by the court of last resort in that state. *Burgess v. Seligman*, 107 U. S. 20; *Flash v. Conn*, 109 U. S. 371, 379; *Clark v. Bever*, 139 U. S. 96; *Board of Liquidation v. Louisiana*, 179 U. S. 622."

Again, in *Sim v. Edenborn*, 242 U. S. 131, 135, this court said:

"This court has many times considered how far federal tribunals, when undertaking to enforce laws of the states, should follow opinions of their courts. The authorities were reviewed, and rule announced in *Burgess v. Seligman*, 107 U. S. 20, 33, 34, 35, which declared that, as to doctrines of commercial law and general jurisprudence, the former exercise their own judgment, 'But even in such cases, for the sake of harmony and to avoid confusion, the federal

courts will lean towards an agreement of views with the state courts if the question seems to them balanced with doubt.' This has been often reaffirmed."

See also—

Barnum v. Okolona, 148 U. S. 393;

Kuhn v. Fairmont Coal Co., 215 U. S. 349.

THE DEPARTMENT WILL NOT BE HEARD TO CONTROVERT THE CONSTRUCTION OF A STATE STATUTE AND A RULE OF PUBLIC POLICY ANNOUNCED BY THE COURT OF LAST RESORT OF THE STATE

Section 10379 is now and always has been a part of the regulatory law of the State of Washington. It is a part of the Act by which the regulatory body of that state was created. It is solely by virtue of that Act that the Department exists. Every particle of the power and authority of the Department is derived solely from that statute.

Now, on what conceivable theory may the Department, an agency of the state, say that the court of last resort of that state has misconstrued the very statute which gives existence to the Department and from which is derived all its power and authority?

As we see it, this court has twice held that it is not open to an agent of the state to attack the construction put by the court of last resort of that state upon the statute creating such agent.

"And, indeed, the necessity for this conclusion becomes doubly manifest when it is borne in mind that the right here asserted to contract in derogation of the state law and of the rule of public policy announced by the court of last resort of the state is urged by municipal corporations whose every power depends upon the state law."

Southern Iowa Electric Co. v. Chariton, 255 U. S. 539, 546.

"Plaintiff in error is not impleaded as a taxpayer nor does he defend as such. He is sued as a county officer and defends by virtue of the exercise of his functions as a county officer. In other words, he defends by virtue of laws of which he is an instrument. Constituted by the laws of the state, he yet attempts to resist one of its laws. Whether he may do so is purely a local question."

Stewart v. Kansas City, 239 U. S. 14, 16.

Respectfully submitted,

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